

**Internal Revenue Service**  
Appeals Office

Release Number: 201521016

Release Date: 5/22/2015

Date: February 27, 2015

**Department of the Treasury**

**Employer Identification Number:**  
XX-XXXXXXX

**Person to Contact:**

Name:

Employee ID Number:

Tel:

Fax:

**UIL: 501.03-05**

**Certified Mail**

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective January 1, 2003.

Our revocation was made for the following reason(s):

You do not operate exclusively for an exempt purpose as required under section 501(c)(3) of the Code. Your primary activity is the operation of a Down Payment Assistance program that does not serve a low-income charitable class.

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

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit [www.irs.gov](http://www.irs.gov).

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

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

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please 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. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit [www.irs.gov/advocate](http://www.irs.gov/advocate) for more information.

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

Sincerely Yours,

XXXXXX  
Appeals Team Manager

Enclosure: Publication 892 and/or 556



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: May 9, 2008

ORG  
ADDRESS

**Taxpayer Identification Number:**  
**Form Number:**  
**Tax Year Ended:**  
**Person to Contact/ID Number**  
**Contact Numbers:**  
Telephone:  
Fax:

**CERTIFIED MAIL – RETURN RECEIPT  
REQUESTED**

Dear

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

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

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

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

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

Letter 3618 (04-2002)  
Catalog Number 34809F

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Letter 3618 (04-2002)  
Catalog Number 34809F

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer ORG		Year/Period Ended 20XX12

LEGEND

ORG - Organization name      XX - Date      Address - address      City - city  
State - state      President - president      CEO - CEO      website - website  
BM-1 - 1<sup>st</sup> BM      CO-1 & CO-2 - 1<sup>st</sup> & 2<sup>nd</sup> COMPANIES

**ISSUE**

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

**FACTS**

Overview

ORG (ORG) is an State not-for-profit corporation incorporated on July 20, 20XX. President is the registered agent and president. The organization's address is Address, City, State.

On August 25, 20XX, ORG applied, under penalties of perjury, for recognition as an organization entitled to tax exempt status under IRC § 501(c)(3) on Form 1023 (application for exemption). On November 23, 20XX, based on the information ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, the Internal Revenue Service (IRS) recognized ORG, as of July 20, 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. As more fully described below, under ORG' 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

As discussed above, on August 25, 20XX ORG filed its application for exemption by with the IRS. . ORG stated its purpose was to:

Provide down payment gifts to individuals and families for the purpose of purchasing a home. To qualify, people must fall into either low or moderate income categories as defined by FHA and/or Fannie Mae. They must qualify

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for a mortgage, demonstrate a need for down payment assistance and purchase a home in the program. We will promote our program through real estate agents, mortgage lenders, and home sellers/builders.

Regarding income limits and financial need, the application stated. "This program is for all home buyers that are low to moderate income and display a need for down payment assistance."

Regarding fundraising and contributions, the application for exemption stated, "ORG's sources of financial support will be from services fees (95%) and charitable contributions (5%)."

### Federal Returns

ORG filed Form 990 for the calendar year ended December 31, 20XX. It was not required to file and did not file Form 990-T. ORG also filed Forms 941, W-2, and 1099-MISC. In 20XX, the only reported activity was ORG' operation of its DPA program, described in more detail below.

According to Part III of the 20XX Form 990 "[ORG] was created to increase home ownership and to move more individuals into an equity position, with 0% down payment. This community focused organization was able to assist 5,283 individuals in 20XX." Part VIII of the Form 990 stated "income received from home sellers as compensation for using programs, processes and materials of the Foundation. Miscellaneous income received while fulfilling the organization's exempt purpose."

In 20XX and 20XX, ORG received \$ and \$, respectively, in gross revenue from amounts paid to it by sellers participating in the ORG DPA program. They did not report the sellers' payments as contributions. Instead, ORG reported these payments as program service revenue. ORG also reported it distributed \$ in down payment assistance to homebuyers for use as down payments and/or to pay for closing costs. The Form 990, Part IV, line 73, showed total unrestricted/net assets of \$ as of December 31, 20XX.

ORG reported distributions of \$ to other charities.

### Operation of the ORG Down Payment Assistance Program

ORG, through its website, flyers, advertising, and other methods, promoted its DPA program to builders, lenders, loan officers, mortgage brokers, real estate agents, title

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insurers, buyers, and sellers. Many of the participants in the ORG DPA program utilized 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 described 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 from 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.

Through the ORG DPA program, buyers receive a "gift" of the funds they use for the down payment. During the years under examination, the down payment "gifts" were 3% of the property's stated sales price. A house buyer was eligible to participate in the ORG DPA program only if the buyer purchased a house from a seller who agreed to ORG's contractual terms. ORG and the sellers entered into agreements requiring sellers to pay ORG an amount equal to the down payment "gift" that the buyer received under the ORG DPA program. ORG claimed the seller's payment was not provided directly to the buyer, but instead was used to "replenish" the pool of funds used to provide "gifts" to subsequent buyers. In addition to requiring the seller to pay an amount equal to the amount of the "gift" provided to the house buyer, ORG required sellers to pay ORG an "administrative fee," usually equal to a set amount of \$.

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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 sellers' home, thereby returning the funds to the sellers.

Despite the representations in its application for exemption, ORG did 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 ORG screened for this data. Rather, the ORG DPA program provided "gifts" to any homebuyers who qualified for loans. For example, on November 19, 20XX, the DPA program provided \$ in down payment assistance to a buyer to purchase a \$ home. On December 8, 20XX, the DPA program provided down payment assistance of \$ to a buyer to purchase a \$ home.

ORG' promotional material and advertising make it clear anyone who could qualify for some type of loan was eligible for the ORG DPA 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 example from the promotional literature 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 homes, manufactured homes and modular homes as well. So start dreaming about your new home today. (Emphasis supplied)

In addition, ORG' documents explicitly state 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 nor does it have any source of funds other than "contributions" from sellers and related fees. Since the amount of the "contribution" is always equal to the amount of the down payment assistance provided to the buyer plus the service fee, the actual source of the down payment assistance is, in fact, the seller's "contribution."

In 20XX, ORG 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-1, a national builder. There were 375 DPA amounts in excess of \$; nine were in excess of \$.



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ORG did not promote 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, its advertisements, and in other promotional materials, ORG states

ORG' Form 990 listed no contributions received; its revenue was reported as program service revenue.

Each seller's contract states: "The seller's contribution paid to the ORG Foundation is not tax deductible as a charitable contribution because the Seller derives full benefit of the contribution through the sale of a home. For questions or clarification, please contact your personal tax advisor." These contracts obligate the seller, in consideration for participating in the ORG 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 Partners in Charity program purchases the participating home."

The parties to the down payment assisted real estate transactions, including the realtors, builders and lenders, benefited more than incidentally from ORG' operations. The following information, taken from some of ORG' promotional materials, clearly demonstrates this benefit.

Sellers ORG advertised its DPA program

[I]s designed to give the seller's house a competitive advantage due to the fact with no down payment required, the seller can attract a larger pool of qualified buyers-- those with good credit, who have enough money to handle the monthly mortgage payment, but simply do not have the assets for a down payment. Typically, it can take weeks or months to sell a home, often resulting in sellers reducing their asking price considerably just to get their house to 'move'. With Preferred Program, more buyers are competing for the same home. So, the seller typically gets the highest price for his or her home in the shortest amount of time."

ORG advertised on its website:

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Realtors ORG' promotional materials and website told realtors they will

(1) Sell more homes-lower seller fees will help you list more homes. A larger pool of qualified buyers will help you sell more homes. (2) Sell homes faster-qualified buyers competing for the same homes will speed up the sales process, subsequently saving you valuable advertising dollars. (3) Make more money-selling homes at appraised/listed price means more commission dollars in your pocket. (4) Guaranteed on time funding-we will gift the buyer the down payment by wiring the funds into closing office within 24 hours before closing-guaranteed. requires no repayment of the "Gift" by the buyer and has no income limits.

The promotional materials gave the following example:

EXAMPLE OF REAL ESTATE TRANSACTION  
(WHEN HOMEBUYER HAS DOWNPAYMENT)

LIST PRICE	\$	
SALES PRICE (WITH 5% APOR)	\$ \$	
LESS COMMISSION	\$ \$	
SUBTOTAL	\$ \$	
LESS CLOSING(APPROX. 1.5%)	\$ \$	
NET	<u>\$ \$</u>	
TRANSACTION		
LIST PRICE	\$	
SALE PRICE	\$	
LESS COMMISSION	\$ \$	
LESS ORG FEE	\$ \$	
SUBTOTAL	\$ \$	
LESS CLOSING(APPROX. 1.5%)	\$ \$	
NET	\$	
REALTOR EARNS	\$	MORE
SELLER NETS	\$	1MORE

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Builders ORG' promotional materials told builders their new construction homes will sell faster with ORG.

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, down payment 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, down payment 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."

#### EXAMPLE

CURRENT COST OF DPA	\$
COST	\$
SAVINGS PER HOME	\$
NUMBER OF HOMES SOLD	
TOTAL SAVINGS	\$

Lenders ORG promotional materials told lenders using the DPM program that ORG will provide the following benefits:

(1) More Profitable--closing more deals, making more money. (2) Faster--state of the art online request system takes about 3 minutes. (3) Easy to use--ultra simple streamlined and uncomplicated, no forms to fax, no signatures required prior to closing. (4) Efficient--we'll handle getting wiring instructions and follow up on closing details. (5) Guaranteed on time funding--you'll receive the funding within 24 hours before the closing-Guaranteed. No stipulations as long as the seller agrees to contribute back the gift amount, plus the low processing fee. 'WE WILL GIFT THE FUNDS' Build lasting relationships by helping realtor/builder partners sell more, faster. The offers a comprehensive array of easy-to-use and proven marketing materials (yard signs, direct mail postcards, door hangers, brochures, newspaper ads, flyers, letters, realtor/builder information packets, and interactive PowerPoint presentations.

Other Parties Benefited by the ORG DPA Program In addition to the intended benefit to the sellers, buyers, realtors, builders and lenders described above, various

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other individuals and entities also were the intended beneficiaries of ORG' operations during the year examined.

CEO (Chairman of the Board). On August 1, 20XX, ORG signed a \$ unsecured line of credit promissory note with CEO. The unpaid principal of this line of credit bore simple interest at the prime rate plus 300 basis points as defined by the majority of the commercial banks as listed in the Wall Street Journal on the date of the first advance. The rate was fixed for a period of five years based upon the prime rate at the time of the first advance and was to remain fixed at that rate for the next five years. The Form 990 indicated as of December 31, 20XX, ORG owed a remaining balance of \$ to CEO.

CO-2. President, president of ORG, is the sole owner of CO-2 (CO-2), a for profit entity incorporated in State. ORG entered into an exclusive agreement for CO-2 to provide: office space, conference room facilities, website hosting, maintenance, telephone service, 24 hour answering service, and clerical and typing services. According to the agreement the CO-2 staff agreed to design and execute a program around the processing for distribution of ORG' grant funds. Tasks included generating and sending marketing materials to prospective lenders and real estate professionals, generating and sending follow up materials to interested lenders and real estate professionals, data entry, demographic tracking and information services. According to the agreement the CO-2 staff agreed to design and execute all client fulfillment systems necessary to the processing of grant requests. Tasks included receiving grant applications, verifying application data, executing and confirming wire transfers, following-up on non-closing purchases, and returning funds on non-closing purchases. The CO-2 staff agreed to provide all bookkeeping services including bank account management, accounts receivable, accounts payable and financial reporting. The CO-2 staff agreed to assist in the process of generating income for ORG. Tasks included securing donations to ORG to perpetuate the available funds for future grants. According to the agreement, CO-2 also provided reproduction work, binders, supplies, training materials and manuals directly incident to the service, paying the cost if outside help was necessary and paying the cost of all forms.

For the agreed upon services ORG paid CO-2 \$ for services rendered in 20XX. This was treated as a "marketing fee" on the Form 990.

## 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,

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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 Washington, D.C. v. U.S., 326 U.S. 279, 283 (1945), the Supreme Court held that the “presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes.”

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

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

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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

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method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in § 501(c)(3).

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

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

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 "charitable" 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 in obtaining improved housing, including (1) conducting a training course relative to 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 analyzed whether each organization qualified as charitable within the meaning of § 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families eligible for loans, under a Federal housing program, who did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic

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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 Service 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.

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In early 2006 the IRS issued Revenue Ruling 2006-27, 2006-1 C.B. 915, which describes three organizations involved in providing down payment assistance and

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determines whether each qualifies for exempt status under § 501(c)(3). The organization described in Situation 1 makes assistance available to low-income families to purchase decent and safe homes throughout the metropolitan area in which it is located. Individuals are eligible to participate if they are low-income and have the employment history and financial history to qualify for a mortgage with the exception that they do not have the funds necessary for down payments.

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

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

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

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

### Benefiting Private Interests

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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

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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 (5<sup>th</sup> 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 (9<sup>th</sup> 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.D.C., 2003), 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 Texas Trade School v. Commissioner, 272 F.2d 168 (5<sup>th</sup> 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.

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

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9<sup>th</sup> 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.

Effective date of revocation

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

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

### ANALYSIS

ORG does not qualify as an organization described in IRC § 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 (3) results in inurement of a substantial portion of ORG' net earnings to the benefit of the organization's officers and other insiders.

Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of the regulations. ORG' 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. The organization did not screen applicants for down payment assistance based on income. Its 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 20XX year, ORG' DPA program provided down payment assistance on hundreds of expensive homes. The program is also not limited to first time homebuyers.

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ORG' 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 IRC Sec. 501(c)(3) .

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if ORG' DPA program were directed to exclusively low income individuals or disadvantaged communities, the organization's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions, demonstrates the DPA 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 this 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 ORG' DPA transactions in 20XX and 20XX involved one particular seller, a national home builder. Buyers who participate in the DPA program benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals and builders who participate in the ORG DPA program benefit by selling more homes due to lowering seller fees, selling homes faster with a qualified pool of buyers, making more money with selling homes at appraised/listed prices; and quicker receipt of funds with ORG process of wiring funds within 24 hours. It is evident the ORG DPA program provides ample private benefit to the various parties in each home sale.

The manner in which ORG operated its DPA program shows the private benefit to the various participants in the program was the intended outcome of ORG' operations rather than a mere incident of such operations. ORG' down payment assistance procedures were designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, ORG relied exclusively on sellers and other real

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estate related businesses that stood to benefit from the transactions. ORG neither solicited nor received funds from other sources.

Before providing down payment assistance, ORG' grant making staff took into account whether there was a home seller willing to make a contribution to cover the down payment assistance the applicant had requested. The organization required the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus an administrative fee of several hundred dollars per home sale. ORG secured an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions took place unless the organization was assured the amount of the down payment plus the fee was paid by the seller upon closing.

ORG' instructions to title and escrow companies provided at the close of escrow the seller's contribution, along with any fees payable to ORG, had to be sent to ORG within 24 hours. Escrow companies that did not appropriately disburse funds in a timely manner were prohibited from utilizing the ORG DPA program. ORG' receipt of a home seller payment equal 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 the organization's operations. In this respect, ORG is similar to 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' own promotional materials and its marketing activities show the organization 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 ORG was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect, the organization'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.D.C., 2003).

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), ORG' 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. The organization's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. ORG did not



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solicit or receive any funds from parties that did not have an interest in the down payment transactions. Like the organizations considered in American Campaign Academy, *supra*, and Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), *aff'd*, 846 F. 2d 78 (Fed. Cir.), a substantial part of ORG' activities furthered commercial rather than exempt purposes.

Furthermore, the organization's activities were structured to provide substantial private benefit to its insiders. The facts establish ORG and CO-2 (CO-2), a for profit corporation wholly owned by President, president of ORG, entered into an exclusive marketing agreement. Under the terms of the agreement, ORG carried out most of its DPA activities through the staff at CO-2. For the year under examination, substantially all of CO-2's gross revenues came from ORG. Like the organization in KJ's Fund Raisers, *supra*, ORG existed for a substantial nonexempt purpose of creating business for CO-2. Thus, like the organization in KJ's Fund Raisers, ORG' operations resulted in a substantial private benefit to ORG' insiders.

ORG operations also resulted in inurement of its charitable assets to ORG insiders, including the chairman of the board, CEO. On August 1, 20XX, ORG borrowed \$ from CEO at an inflated rate of interest. In the absence of any proof this loan was fair and beneficial to ORG, the loan should be treated as inurement of ORG' net earnings to CEO. See The Founding Church of Scientology, 412 F.2d at 1200-01.

ORG entered into an exclusive marketing agreement with CO-2, a for profit entity owned by President, president of ORG.. For the agreed upon services, ORG agreed to pay CO-2. 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-2 were excessive, a portion of ORG' net earnings inured to CO-2 and, indirectly, to President. 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-2's services, ORG' marketing arrangement with CO-2 should be treated as resulting in inurement of ORG' net earnings to CO-2 and, indirectly, to President.

During the year under examination, ORG' principals had unfettered control over the organization and ready access to the organization's assets, including cash. President had sole authority over bank accounts and was the only signatory on all of the accounts. Internal controls were lacking. The Board of Directors consisted of three individuals: President, CEO, and BM-1. The directors merely approved, retroactively, all transactions that occurred during the year and elected themselves for another term. This is demonstrated by the one page minutes for the annual meeting, the only documentary evidence the board took any action during the year under examination.

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This lack of oversight by the board allowed inurement to occur. The facts show numerous transfers of ORG' charitable assets for the benefit of 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 failed to provide acceptable justification for the transfers of its charitable assets to insiders, the transfers should be treated as inurement of ORG' 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).

The government proposes revoking the tax exemption for ORG back to the organization's inception, July 20, 20XX. The organization operated in a manner materially different from what was represented in its application for exemption. 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. 2003-4, § 14.01. Therefore, ORG' actual operations of its DPA program in a manner materially different from what was represented in its application for exemption, justifies retroactive revocation of its tax exemption.

### 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. The ORG DPA program did not operate in accordance with IRC § 501(c)(3) and the regulations and Revenue Ruling 2006-27. ORG provided down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. ORG offered down payment assistance to interested buyers regardless of the buyers' income levels or needs. ORG' DPA activities did not target neighborhoods in need of rehabilitation or other relief, such as lessening neighborhood tensions or eliminating prejudice and discrimination.

ORG operated in a manner indistinguishable from a commercial enterprise. The organization's primary activity was brokering transactions to facilitate the selling of homes. The primary goal was to maximize the fees from these transactions. ORG brokering services were marketed to homebuyers, sellers, realtors, lenders, home builders, and title companies regardless of the buyers' income levels or needs and regardless of the condition of the community in which the home is located. Alliances

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were built with the realtors, lenders, home builders, and title companies to assure future business for the mutual benefit of the participants. ORG did not engage in any counseling or other activities that further charitable purposes. Because ORG' primary activity was and continues to be 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' activities resulted in inurement of charitable assets to ORG insiders. These insiders had total control over the organization and ready access to the organization's assets, including cash. The organization paid unjustified amounts of compensation to a related for profit entity for marketing services. All of this constitutes evidence assets and/or earnings of ORG inured to insiders in violation of §501(c)(3).

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

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

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