



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **200623075**
Release Date: 6/9/2006

SE:T:EO:RA:T:2

Date: March 17, 2006

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear Applicant:

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Information letter

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: January 19, 2006

Contact Person:

Uniform Issue List: 501.00-00

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

M =
N =
R =
S =
A =
X =
Y =
Z =
State =
Date =

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

FACTS

You, M are a State non-profit corporation, formed on Date. Your Articles of Incorporation state that you are organized for charitable purposes in accordance with the meaning of Internal Revenue Code section 501(c)(3).” Your specific purpose is “to provide assistance, education and credit counseling for consumers.”

Your application Form 1023 and supplement responses state that you will provide gift funds to eligible automobile buyers ("eligible buyers") who purchase selected vehicles from participating dealers.

You state that an eligible buyer is a buyer whose income does not exceed 80% of the area median income and who is purchasing a vehicle that does not exceed the vehicle affordability ratio ("VAR") in conjunction with a sales transaction compatible with a gift from M. You state that eligible buyers are referred to M by participating dealers who will determine if the buyer meets eligibility requirements.

You further state that participating dealers who have been identified through recruitment efforts of M and make an irrevocable pledge to you in \$x increments. You state that the irrevocable pledge is a charitable contribution made by the participating dealer to M. The participating dealer places the funds to a "gift account." You state that you will agree to reserve and give each participating dealer priority in such funds contributed by the dealer, known as the "reserve funds" for a specified time period ("reservation period"). You state that once this time period has elapsed, the funds become unrestricted and you may use them for any purpose.

You state that there are no participation applications; however, the participating dealer must execute a software license agreement to utilize an online processing application developed by R for M. You state that once an eligible buyer has qualified to receive financing to purchase an automobile from the participating dealer, the participating dealer requests gift funds on behalf of the eligible buyer using the processing system. The buyer does not need to repay the gift. \$4y from each pledge is used to provide gifts of \$y each to eligible buyers. The remaining \$y is used by you to cover administrative costs and raise funds.

You state that your program transfers funds to the dealer on behalf of the buyer using the reserved funds set aside for this purpose. You described the transaction as including the following steps:

1. The dealer logs onto the processing system website to request funds from M on behalf of the eligible buyer.
2. The processing system will check to see if that participating dealer has reserved funds available in the dealer's gift account or the general gift account. If funds are available, the processing system will debit \$y from the dealer's reserved funds in the gift account or the general fund account plus an additional amount as the processing fee.
3. Prior to any funding being provided, the eligible buyer signs or

electronically signs a gift application.

4. After final approval is issued through the processing system, the funds will be transmitted to the participating dealer.
5. Funds become the property of the eligible buyer once the purchase transaction is completed.

You state that if the dealer has not requested funds sufficient to exhaust the dealer's reserve funds within the reservation period, you reserve the right to allocate those funds to your general gift fund. You also state that the dealer will return any funds to you, if the purchase transaction is not completed.

You state that neither you nor the dealer will require the buyer to repay the gift, unless the vehicle purchase is rescinded pursuant to a provision of the conditional sales contract allowing rescission, then the contract terms of the gift application require the buyer to return the gift.

You state that a vehicle may not exceed the "vehicle affordable ratio" ("VAR"), which is established by M for the county in which the dealership is located. You state that the purpose of the VAR is to establish a maximum monthly payment on an automobile that you have provided gift funds for, so that the purchaser is not purchasing an automobile outside of the purchaser's means based on standards guidelines. You indicate that you determine the VAR by using a ratio of total annual automobile loan payments divided by 80% of area median income. You state that M devised and established this concept based on the auto industry's "best practices," which states that annual aggregate auto payments should not exceed 20% of the buyer's annual income. However, you state that the financing terms of the vehicle are based on the agreed sales price and does not take into consideration the gift provided by M to the buyer.

Your contribution agreement from S states that in addition to your auto gift program, your mission is to provide financial assistance, education and credit counseling to low-income automobile purchasers and to provide transportation for low-income persons and persons with special needs. Additionally your strategic plan indicates that you will be involved in education, credit management, financial planning and vehicle donations. Further, you indicate that you will engage in fundraising through golf tournaments and solicitations from the general public.

In your letter dated February 13, 2004, you state that in addition to your auto gift program, you will be involved in fundraising, consumer education where you will develop a consumer booklet on the care, maintenance and financial planning associated with automobile ownership. You further stated that you will providing funding to

assist social service, charitable and government agencies with purchasing a vehicle. You also indicated that you will provide transportation for the needy in partnership with social service agencies. You state that your auto gift program should permit you to raise funds to purchase automobiles for such agencies. However, you did not state or otherwise indicate that you will be conducting credit counseling or related activities.

You have retained the services of N to provide you with consulting services. The agreement provides that N will develop a strategic plan and operating budget for you. N will also develop your website and will provide ongoing staff support services to you. For such services, N will be paid a retainer of \$7y per month. In your letter of February 13, 2004, you state that A is the sole member of N.

You have also retained the services of R to provide you with the technology to administer your program. The processing agreement provides that R will provide M with an online processing system to coordinate the transfer of gift funds among the various parties. M will pay a processing fee of \$2z to R for each transaction conducted using the software system developed by R. In addition, the agreement has a "minimum transaction level" requirement, which states that M agrees to use its best efforts to process "as many transactions as possible . . . to provide economies of scale to R." In your letter of February 13, 2004, you state that A is an officer and director of R.

LAW

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

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

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

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

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term “charitable” as used in section 501(c)(3) of the Code as including the relief of the poor and distressed or of the underprivileged. The term “charitable” also includes the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations provides, in part, that the term “educational” as used in section 501(c)(3) of the Code relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

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

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

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

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

organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner.”

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops be operated for exclusively charitable purposes within the meaning of section 501(c)(3) of the Code. The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from these communities of craftsmen. It did not select individual craftsmen based on the needs of the purchasers. The court concluded that the overall purpose of the activity was to benefit disadvantaged communities. The method it used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes.

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

Rev. Rul. 72-147, 1972-1 C.B. 147, holds that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) of the Code because it gave preference to employees of a business operated by the individual who also controlled the organization. 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.

Rev. Rul. 77-246, 1977-2 C.B. 2 190, holds that a nonprofit organization that provides, upon request, low cost bus transportation to seniors citizens and handicapped persons in a community where public transportation is unavailable or inadequate qualifies for exemption under section 501(c)(3) of the Code as operated exclusively for charitable purposes.

RATIONALE AND CONCLUSION

Based on the information you provided in your application and supporting documentation, we conclude that you are not operated for exempt purposes under section 501(c)(3) of the Code. An organization cannot be recognized as exempt under section 501(c)(3) unless it shows that it is both organized and operated exclusively for charitable, education, or other exempt purposes. Among other things, the application and supporting documentation must demonstrate conclusively that the organization meets the operational test of section 1.501(c)(3)-1(c) of the regulations. Your information indicates that your primary purpose is to operate a

down payment assistance program that does not exclusively serve a purpose described in section 501(c)(3).

Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of the regulations. However, you do not conduct your down payment assistance program in a manner that establishes that your primary purpose is to address the needs of low-income persons who do not otherwise have any means of transportation.

You have not demonstrated that your down payment assistance program exclusively serves any other exempt. You do not specifically target the benefits of your program towards any one disadvantaged group. Your information indicates that you do not limit your assistance to certain geographic areas or target those areas that do not have access to transportation. See Rev. Rul. 77-246. Providing a set aside account to help dealers provide a rebate to automobile purchasers does not combat community deterioration within the meaning of section 501(c)(3) of the Code.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, *supra*, the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. You conduct your operations in a manner that is consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve a charitable class or the public at large. The manner in which you operate your down payment assistance program indicates that you facilitate the sales of automobiles in a manner that is indistinguishable from an ordinary trade or business. You operate as a business that provides services to participating dealers for which you charge a market rate fee. For example, your sample transaction explains how the participating dealer will be able to sell more vehicles by utilizing your program. This type of approach helps to demonstrate that your primary purpose consists of maximizing the fees you derive from facilitating sales of automobiles. In this respect you are similar to an organization which was denied exemption because it operated a conference center for a commercial purpose. See Airlie Foundation, Inc. v. U.S., 283 F. Supp. 2d 58 (D.D.C., 2003). Likewise, operating a trade or business of facilitating car sales is not an inherently charitable activity. Thus, a substantial part of your activities further a nonexempt purpose.

Another indication of your substantial nonexempt purpose is your lack of public support. You are not supported by contributions from the general public, government or private foundation grants. Almost all of your revenue comes from the participating dealers you serve. That your primary activity is to promote and to further your private business interests is reflected in the financing structure of your down payment assistance program. In this respect you are similar to the organization described in Easter House, *supra*, which derived most of its support from fees it charged for its adoption services. In this case, the court stated that the substantial fees were not incidental to the organization's exempt purpose because they were designed to make a profit. Facilitating car sales, like running an adoption service, is not an inherently charitable activity, and receiving support primarily from fees charged to participating dealers is indicative of your commercial purpose.

Your reliance entirely on participating dealers that stand to benefit from the transactions to finance your down payment assistance activities demonstrates that you are operated for the

purpose of benefiting private parties.

Your grant making procedures indicate that gift funds are only provided if a participating dealer has made a contribution to you. In fact while you call the funds you will receive from the sellers "contributions", these transactions are not contributions because they will not "proceed from detached and disinterested generosity." Commissioner v. Duberstein, 363 U.S. 278, 285 (1960). Your characterization of these transactions as contributions ignores the business realities surrounding the payments. The participating dealer will make the payments to you and indirectly to the buyer to facilitate the sale of automobiles.

You represent that the participating dealer's payment will enable the buyer purchase an automobile by providing a down payment. However, the participating dealer's "contribution" are more appropriately characterized as a rebate or purchase price reduction. The fees are received in exchange for the sale of a service. Your information indicates that your staff is able to take into account whether the participating dealer has provided funds to cover the down payment assistance when an application is received. Similar to American Campaign Academy, *supra*, you are structured and operated to directly benefit the participating dealers who pay for your services. Therefore, a substantial part of your activities serve a private rather than a public interest.

Based on the facts and information submitted, you are not operated exclusively for exempt purposes. You have not established that you activities exclusively serve a charitable class or any other purpose defined in section 501(c)(3). Your proposed operations further a substantial nonexempt business purpose and will further the private interests of participating dealers and other private parties. Therefore, you are not described in section 501(c)(3) of the Code.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

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

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax

Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:2)
1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements