



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200645025**
Release Date: 11/10/06
Date: 08/19/05
UIL: 501.03-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

M =
N =
O =
P =
State=
Date=
Z =

Dear _____ :

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 exclusively for charitable, religious, educational and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt under section 501(c)(3) of the Code. Your specific purpose is "[t]o provide homebuyers with down payment and housing assistance." The Articles further provide that you are "[a] charitable development corporation that provides gift funds to qualified low-to-moderate income individuals, families, minorities, and the traditionally under served for down payment and/or closing costs to purchase a home."

Your bylaws provide that the number of directors shall be three; however, your letter of July 12, 2004, indicates that you currently have 2 directors, because one resigned. Your President is N, who also is one of the directors. N's spouse is the Secretary of M. Your initial capitalization was from loans borrowed from N, and from O, a marketing company. O is a State Limited Partnership, whose general partner is P, a State limited liability company whose single member is N, and whose two limited partners are N and N's father. You indicate that you believe that the repayment terms, including interest rates assessed, are in line with investor financing. You did not indicate extent to which other forms of financing were considered, or how you determined that the terms were reasonable.

In addition, you have secured the services of O under a marketing agreement for promotion, marketing, advertising, client training and client support for your Program. O is responsible for providing local and regional marketing and customer support functions for you in target metro/housing markets through the United States. The terms of the agreement is for four years, renewable annually after the initial term, for a fee equal to 60 percent of the Program and Processing fees, and will be assessed with each down payment assistance case. You share office space and a mailing address with O.

Your letter of July 12, 2004, shows proposed budgets for 2005 and 2006, with salaries and wages for officers and others. Your letter of April 26, 2005, includes a profit/loss statement for fiscal year 2004, and shows salaries and related expenses of \$8.5z, which is equal to approximately 67 percent of total expenses for the year.

Your Form 1023 Application states that your activities will consist of providing gift funds to qualified participants to be used solely to meet the cash down payment and closing cost requirements of acquiring a particular home. Qualified participants will include low to moderate income, minority and traditionally underserved prospective home buyers. Applicants must qualify for a mortgage, demonstrate need for down payment assistance, and purchase a home in your program.

In reference to this service your Application (as revised by letter dated April 26, 2005) indicated that you will:

1. Evaluate prospective participants in the organization's program to determine whether the prospective participant is in a class of persons traditionally underserved in the home buying market place. You anticipate that this activity will take approximately 10 percent of the organization's time.
2. Evaluating the funding requirements of the organization. The organization will determine which source of funds the organization will utilize to assist the home buyer at the lowest cost to the organization. The funds can come from cash reserves, line of credit, short-term working capital loan and/or any combination of these. You anticipate this activity to take approximately 30 percent of your time.
3. Promoting your program to home buyers, home builders, home sellers, real estate professionals, mortgage lenders, closing agents and the general public. The promotional efforts will provide program awareness to all of these groups so that the

organization has a ready source of participants. You anticipate this activity to take approximately 20 percent of your time.

4. Providing down payment assistance by processing assistance to the home buyers and receiving seller contributions. You anticipate that this activity will encompass approximately 40 percent of your time.

You state that your down payment assistance program transfers funds at settlement using a pre-existing pool of funds to provide a buyer with the required down payment amount towards the purchase of a seller's home. You indicated that evaluating funding requirements comprises approximately 30 percent of your time. This involves a determination of the number of pending down payment assistance requests for future funding. You make a determination as to whether there are enough contribution funds in the down payment assistance pool and/or whether funds from contributions not yet received will be available to fund all current down payment assistance requests without using short term banking financing to fulfill those assistance requests. If there are sufficient funds to meet the pending requests, you will then use funds from the pool and wire the required assistance funds to the escrow/closing office one day prior to the scheduled closing. If there are not sufficient funds to meet the pending requests, you will then proceed to evaluate the incremental amount of funds that will be required above the available funds that is needed from short term bank financing. If short term bank financing is needed, a list of your current Account Receivables (which you indicate are contributions committed but not yet received from sellers/builders, per the Participating Home Agreement) will be forwarded to a third party bank to be used as security for the financing. Thus, the financing will be on an as needed basis. The short term financing balance is paid off upon receipt of the accounts receivable.

Your Application and letters dated July 12, 2004, and April 26, 2005, describe your down payment assistance program as follows:

1. Potential buyers needing down payment assistance are located and identified by any number of sources: website, direct mail, and referrals from mortgage lenders, realtors, builders, sellers, etc.
2. A potential buyer is put into contact with a mortgage lender if they don't already have a mortgage lender to work with. The mortgage lender determines if the buyer will require down payment and/or closing cost assistance in order to qualify for a mortgage to purchase a home. If the buyer needs assistance, then the mortgage lender qualifies the buyer for a mortgage that will accept gift funds. The mortgage lender determines the amount of assistance needed by the buyer, and then sends a Gift Funds Request to you. The Gift Funds Request form asks the buyer for limited information such as annual income, mortgage lender, loan type, property to be purchased, ethnicity, and gender.
3. The buyer also completes the Gift Letter form. The Gift Letter provides that the buyer understands that the gift funds provided are not made available from any person or entity with an interest in the sale of the property including the seller, real estate agent or broker, builder, loan officer, or any entity associated with them.

4. In addition, the letter states that the buyer is under no obligation to repay the down payment assistance received for the purchase of the home.
5. When the home buyer acquires the home, builder or seller will contribute a total amount equal to the gift funds, up to 6 percent of the home sales price, plus a processing fee of one percent of the home sales contract price, or \$750, whichever is the less. If the buyer has located a participating home to purchase, then a copy of the Participating Home Agreement, which has been completed by the seller, is faxed to you for review and approval of the assistance. If the buyer has not located a participating home to purchase, then the buyer is referred to a realtor to help the buyer locate a participating home.
6. A participating home is one in which the builder or seller agrees to participate in your program by completing and signing a Participating Home Agreement. This form indicates that you are providing the seller with an additional resource and opportunity to sell their home by making their home available to a larger pool of potential buyers through down payment assistance. Pursuant to the agreement, the seller agrees to make the contribution to you for a certain amount, and to pay the processing fee. Seller acknowledges that they are under no obligation to make the contribution if closing does not occur and any funds not used will be returned to seller. The agreement instructs the seller that the contribution may be deductible as a cost of sale, and that the seller should consult their tax advisor for more information.
7. The buyer submits a full price offer to the seller/builder to purchase their home. Once the seller/builder has accepted the buyer's offer to purchase the Participating Home and the buyer has been approved for the loan that will accept gift funds from you, then the lender forwards all executed down payment assistance documents to the closing agent to review and forward to you.
8. You review the Gift Funds Request, Participating Home Agreement and Closing Office Registration documents for accuracy and to make the final approval for assisting the buyer.
9. The buyer must meet two qualifications to participate in your program and receive down payment and/or closing cost assistance. First, they must qualify for a mortgage loan that will accept gift funds from a charitable organization for their funds to close, and second, purchase a home participating in your program. If the buyer has met these two qualifications, you approve the requested buyer's assistance, send a Gift Letter for the buyer, send a closing acknowledgement to the closing agent and wire the funds for the buyer's assistance to the closing agent's escrow account just prior to closing. Prior to closing, the closing agent applies the gift funds to the buyer's funds to close per your Gift Letter. At the closing, the closing agent deducts the seller's contribution to you from the seller's proceeds per the Participating Home Agreement. After closing, the closing agent forwards the seller's contribution to you via a wire or certified funds.

You stated that you do not limit buyer participation based on income or assets. You review information provided by lenders on the Gift Funds Request. Upon receiving this information, you evaluate each request for participation to determine whether the potential buyer/participant meets your criteria for participation in the program. You evaluate each

potential participant on a case by case basis. You state in your letter of May 17, 2005, that if a potential participant has been qualified by a lender under an FHA loan program, then the homebuyer automatically qualifies for participation. If the loan program type, as indicated on the Gift Funds Request, is "other" (the only other choice is "FHA"), then the request is reviewed to determine if the participant meets your criteria. Your criteria includes: (a) each participant is in a category of persons financially distressed or historically underprivileged in the United States because they did not possess the financial ability to acquire homes without financial assistance from a charity or a government agency and/or they were in a class of persons traditionally underserved; and (b) when the grant of gift funds directly lessens the burdens of various governmental agencies because without such grant of gift funds these persons would have to seek financial assistance from one or more governmental agencies in order to acquire a home.

Of four examples of participants that received gift funds from you, as described in your letter of May 11, 2005, you indicated that three were chosen because they qualified for FHA financing. You stated that the fourth participant was chosen based on (a) their Hispanic American ethnicity, which you stated, put them in a class of persons traditionally underserved in the United States, and (b) because they did not have the financial means to make the substantial down payment on the particular home.

You indicated in your letter of July 12, 2004, that you plan to receive contributions by only one method, the Participating Home Agreement with sellers and builders. You do not plan to solicit or receive contributions outside of the Participating Home Agreement. More than 80 percent of the seller contributions received will be used to benefit the home buyers being served and the rest will be used directly by you.

You state in your letter of July 12, 2004, that the total amount of the seller contribution is an amount equal to the dollar amount of the assistance provided to the buyer plus a processing fee. The contribution is contingent upon the sale of the home in your program. The seller contribution is not refundable if the home is purchased by a buyer participating in the program. Additionally, the seller is only committed to make a contribution if a buyer receiving assistance from you purchases the home. The contribution is made after the closing. The closing agent withholds the contribution from the seller's proceeds of the sale per the Participating Home Agreement.

You further provide in your letter of July 12, 2004, that the contribution by the seller is paid in exchange for a service provided by you, because by participating in your program, the home of the seller is available to a much larger pool of qualified buyers. Your letter explains that you expect that the program will be used most of the time in real estate markets that are categorized as "buyer's markets" - those markets where the seller/builder must reduce the sales price in order to sell their property. You encourage realtors and sellers using the program not to reduce the price of their home, but this is not specifically included in the Participating Home Agreement.

You stated in your letters of July 12, 2004, and April 26, 2005, that you provide no services to the homebuyer/homeowner after the close of the sale. You further indicated that you will not conduct any other programs and/or services beyond the down payment assistance. You do not plan to conduct any educational programs other than participating in home buying seminars offered by realtors, lenders, builders and/or closing agents. The extent of your participation is providing an overview of your program, and educating potential homebuyers on how they can participate in your program in conjunction with the services offered by other entities. You recommend, but do not require, that homebuyers obtain a home inspection prior to purchasing a home. You do not review home inspections or home warranties.

The manner in which you operate is referred to as "seller-funded downpayment assistance" in the Final Report, *An Examination of Downpayment Gift Programs Administered by Non-Profit Organizations*, commissioned by Office of Housing, United States Department of Housing and Urban Development, HUD Contract No: C-OPC-22550/M0001 (March 1, 2005). The report concludes that seller-funded downpayment assistance for mortgage downpayments has led to underwriting problems that require immediate attention. Furthermore, the report concludes that the effective costs of homeownership are increased even more by the processing fees charged by the seller-funded downpayment assistance providers which get passed through to borrowers in higher property prices. A copy of the report is enclosed with this determination letter.

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.”

In Church of Eternal Life and Liberty, Inc. v. Commissioner, 86 T.C. 916, 926 (1986), the court stated that while the payment of reasonable salaries does not constitute prohibited inurement, the payment of excessive salaries does.

Rev. Rul. 67-138, 1967-1 C.B. 129, holds that helping low income persons obtain adequate and affordable housing is “charitable” because it relieves the poor and distressed or underprivileged. The organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) coordinating and supervising joint construction projects, (2) purchasing building sites for resale at cost, and (3) lending aid in obtaining home construction loans.

Rev. Rul. 70-585, 1970-2 C.B. 115, discusses four examples of organizations providing housing and whether each qualified as charitable within the meaning of section 501(c)(3) of the Code. Situation 1 describes 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 provides financial aid to eligible families who do not have the necessary down payment. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling holds that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 describes 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 is made available to members of minority groups who are unable to obtain adequate housing because of local discrimination. The housing units are 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 holds that the organization was engaged in charitable activities within the meaning of section 501(c)(3) of the Code.

Situation 3 describes 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 was generally old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area; it sponsored a renewal project; and involved residents in the area renewal plan. The organization also purchased apartment buildings 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 holds that the organization is described in section 501(c)(3) of the Code because its purposes and activities combated community deterioration.

Situation 4 describes 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 section 501(c)(3) of the Code because the organization's program did not provide relief to the poor or further any other charitable purpose within the meaning of section 501(c)(3) and the regulations.

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. 85-1, 1985-2 C.B. 177, discusses whether an organization that provides funds to a county's law enforcement agencies to police illegal narcotic traffic lessens the burdens of government. The ruling holds that an activity is a burden of government only if there is objective manifestation by a governmental unit that it considers such activities to be its burden. The ruling also holds that little weight should be given to statements of government officials that merely praise or express approval of an organization and its activities. Rather, the government must

formally recognize the organization and its functions as relieving its burdens. The ruling sets out relevant factors in determining whether the governmental unit has made the necessary objective manifestation, including:

- a. A statute specifically creates the organization and clearly defines the organization's structure and purposes.
- b. The activity is an integral part of a larger governmental program, or is acted jointly with a governmental unit.
- c. The governmental unit controls the activities of the organization, such as appointing all the board members.
- d. The organization pays governmental expenses.
- e. Regular government funding of the organization's activities through grants or general obligation bonds backed with the full faith and credit of the governmental unit (as opposed to general revenue bond financing).
- f. The governmental unit is not prohibited from performing the particular activity.

Rev. Rul. 85-2, 1985-2 C.B. 178, holds that an organization is lessening the burdens of government if it engages in activities that a governmental unit considers to be its burden and such activities actually lessen such governmental burden. An organization must demonstrate through all the relevant facts and circumstances that a governmental unit considers the organization to be acting on its behalf, thereby freeing up the government assets that would otherwise have been devoted to the particular activity.

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 or of the underprivileged. 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 grantees by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1.

Your down payment assistance program does not serve exclusively low-income persons. Instead, your program is open to anyone without any income limitations. You have not demonstrated that your down payment assistance program exclusively serves any other exempt purpose such as combating community deterioration and lessening racial tensions. Although you state that you seek to serve a class of persons traditionally underserved, you have not

provided any statistics or government programs that show that persons you serve are indeed underprivileged or discriminated against. You have not shown that your program is designed to attract a mixed-income group of homeowners to a specifically defined geographical area that has a history of racial problems. See Rev. Rul. 70-585, Situations 2 and 3

Your information indicates that you do not limit your assistance to certain geographic areas or target those areas experiencing deterioration or racial tensions. See Rev. Rul. 70-585, Situation 4. Your program is available to anyone who is able to qualify for an FHA mortgage from any lender in any State in the United States. Arranging the purchase of homes in a broadly defined metropolitan area does not combat community deterioration within the meaning of section 501(c)(3) of the Code.

Furthermore, you do not engage in any activity to ensure that the house will be habitable or that the buyer will be able to afford to maintain the house over time. Instead, you rely solely on the mortgage lender, insurance agency, home inspector or other third party to conduct such review. You do not provide oversight or conduct any educational program or other activity to ensure that buyers are purchasing properties that are safe, decent, sanitary, and affordable.

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 homes in a manner that is indistinguishable from an ordinary trade or business. You operate as a business that provides services to home sellers for which you charge a market rate fee. For example, your literature and website explain how the seller and agent will benefit from your program as sellers are able to sell their homes at the full list price. This type of approach helps to demonstrate that your primary purpose consists of maximizing the fees you derive from facilitating sales of real property. 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 home 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 sellers 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 home sales, like running an adoption service, is not an inherently charitable activity,

and receiving support primarily from fees charged to home sellers is indicative of your commercial purpose.

Even if your program were changed to be directed to exclusively low-income individuals, your reliance entirely on home sellers or other real-estate related businesses 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 seller has paid a processing fee and 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 sellers will make the payments to you and indirectly to the homebuyer to facilitate the sale of their homes. In effect, these payments have a circular character to them. Upon the closing of the sale, the sellers “contribution” to you is returned to seller as part of the proceeds the seller receives from the sale of the home.

These “contributions” are appropriately characterized as fees received in exchange for the sale of a service. Your information indicates that your staff is able to take into account whether there is a home seller willing to make a payment to cover the down payment assistance an applicant has requested. That you receive a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller is not a mere accident but rather an intended outcome of your operations. In this respect, you are like Easter House, *supra*, which provided health care to indigent pregnant women, but only when a family willing to adopt a woman’s child sponsored the care financially. Similar to American Campaign Academy, *supra*, you are structured and operated to directly benefit the home sellers who pay for your services. Therefore, a substantial part of your activities serve a private rather than a public interest.

You also proffer that by encouraging home ownership, your program furthers the charitable purpose of lessening the burdens of government. Rev. Rul. 85-1, *supra*, holds that an activity is a burden of government only if there is an objective manifestation by a governmental unit that it considers such activities to be its burden and the government formally recognizes the organization and its functions as being a governmental burden. You have not provided any facts, documentation, or otherwise that indicates that your down payment assistance program is a burden of the government or that a governmental unit formally recognizes your activities as an integral part of a larger governmental program. Also see Rev. Rul. 85-2, *supra*.

Moreover, you have not established that your net earnings will not inure to the benefit of private shareholders or individuals. You indicate that salaries will be paid to some of your officers. However, you have not explained in sufficient detail what services these officers will perform in return for the compensation and how those services further exempt purposes within the meaning of section 501(c)(3). You have not established that these compensation levels are reasonable. You also state that you will use the services of a marketing company owned, directly or indirectly, by your President/director and a family member of the President. However, you have not established that the fee paid will be reasonable or the process in which this

particular company was chosen. You have not established that the “compensation” and marketing fees will be anything other than a distribution of your net earnings to these individuals.

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 home sellers and other private parties. In addition, you have not established that your net earnings will not inure to the benefit of private shareholders or individuals. 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 protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section 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 administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with section 6104(c) of the Code.

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below:

Internal Revenue Service
TE/GE Exempt Organizations
SE:T:EO:RA:T:2
Attn : Mary Jo Salins
1111 Constitution Ave, N.W., Rm. PE-3P3
Washington, D.C. 20224

If it is convenient, you may also fax your reply using the fax number shown in the heading of this letter. If you fax your reply, please contact the person whose name and number are shown in the heading of this letter to confirm that your fax was received.

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

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

Enclosure(s)

Notice 437

An Examination of Downpayment Gift Programs Administered by Non-Profit Organizations

HUD Contract No: C-OPC-22550/M0001 (March 1, 2005)