



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examination

625 Fulton Street, Room 503

Brooklyn, NY 11201

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

August 29, 2007

Number: **200747024**
Release Date: 11/23/2007

Taxpayer Identification Number:

ORG

Person to Contact:

UIL: 501.03-01

Identification Number

Contact Telephone Number:

LAST DATE FOR FILING A PLEADING
WITH THE TAX COURT, THE CLAIMS
COURT, OR THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT
OF COLUMBIA:

Dear :

This is a final determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Recognition of your exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3) is retroactively revoked to because it is determined that you are not operated exclusively for an exempt purpose.

IRC 501(c)(3) exempts from taxation organizations which are organized and operated exclusively for charitable or educational purposes, no part of the net earnings of which inure to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which do not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

We have determined that you are not operating exclusively for charitable or educational purposes. A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance you rely on home sellers and other

real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated primarily to further your insiders' business interests. Therefore, you are operated for a substantial nonexempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in section 501(c)(3).

Because your primary activity is not conducted in a manner designed to further IRC section 501(c)(3) purposes, you are not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the code.

Therefore, we are revoking your exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code effective

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for all years beginning

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

If you decide to contest this determination in court, you must file a pleading seeking a declaratory judgment in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia before the 91st day after the date this final determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing pleadings for declaratory judgments and refer to the enclosed Publication 892. You may write to these courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, D.C. 20217

United States Court of Federal Claims
717 Madison Place, NW
Washington, D.C. 20005

United States District Court for the District of Columbia
333 Constitution Avenue, NW
Washington, D.C. 20001

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 too-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer advocate at: Internal Revenue Service,
.....

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely Yours,

Marsha A. Ramirez
Director, EO Examinations

Enclosure:
Publication 892



DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE Exempt Organizations Examinations Division
915 Second Avenue M/S W540
Seattle, Washington 98174

January 22, 2007

Taxpayer Identification Number:

Form:
990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

Certified Mail - Return Receipt Requested

Dear _____ :

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

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

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

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

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

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,

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended	
A DBA B	C	D	

Legend:

A = NAME OF THE ORGANIZATION
 B = DBA
 C = TAXPAYER IDENTIFICATION NUMBER
 D = YEAR/PERIOD ENDED
 E = EXEMPTION DATE
 F = STATE 1
 G = STATE 2
 H = PRESIDENT
 I = VICE PRESIDENT
 J = BANK ACCOUNT NUMBER 1
 K = BANK ACCOUNT NUMBER 2
 L = PERIOD UNDER EXAMINATION
 M = BANK ACCOUNT NUMBER 3
 N = APPLICATION OF EXEMPTION DATE
 O = EFFECTIVE DATE OF EXEMPTION
 P = FORM 1120 FILING PERIOD

Issue

Whether an organization, whose primary activity is operating a "down-payment assistance" program is operated exclusively for charitable purposes within the meaning of IRC 501(c)(3)?

Facts

Overview

A, DBA B ("A"), Employer Identification Number C, was recognized as an organization exempt under Section 501(c)(3) of the Internal Revenue Code in E.

The organization was incorporated under the laws of the State of F as a non-profit corporation on December 24, . On October 24, , A applied to do business with the State of G, Department of Commerce and on December 21, , A filed to do business as B. According to the F Secretary of State web site, A's status shows as active and in good standing. According to the G Secretary of State web site, A's status shows as expired for failure to file a renewal. B status shows as expired for failure to file a renewal.

The purposes of A, according to its Articles of Incorporation, are as follows:

1. *to bring together inventors, copywriters, artists, and those who desire to be creative for the purposes of developing creativity, protecting ideas, securing patents, securing copyrights, securing licenses, creating new and better products and services, as well as marketing such products and services.*
2. *to purchase or otherwise acquire, hold, own, manage, lease, mortgage, sell, convey, auction, subdivide, or otherwise dispose of real or personal property of every class and description in*

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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furtherance of its non-profit objectives in any state or interest therein in any of the states, districts, territories, colonies, or countries, subject to the laws of such state, district, country, territory, colony or protectorate and further subject to the provisions of subparagraph (e) of this paragraph THIRD.

3. *except as hereinafter provided in subparagraph (e) of this paragraph THIRD, to engage in any lawful act or endeavor for which non-profit corporations may be organized under the "F Non-Profit Corporation Act."*
4. *except as hereinafter provided in subparagraph (e) of this paragraph THIRD, to do each and everything necessary, proper, or convenient for the accomplishment of any of such purposes.*
5. *Notwithstanding anything in these Articles of Incorporation to the contrary, no part of the net earnings nor of the principal of said corporation shall inure to the benefit of or be distributable to its members, trustees, officers, or other private person except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes stated above at paragraph (a) of this paragraph; and no substantial part of the activities of the corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation and the corporation shall not participate in or intervene in, (including the publishing or distribution of statements), any political campaign on behalf of any candidate for public office and the corporation shall not carry on any other activities not permitted to be carried on by a corporation exempt from federal income tax under Section 501 (c) of the Internal Revenue Code of 1954, (or the corresponding provision of any future United States Internal Revenue law).*

Application for Recognition of Tax-Exempt Status

According to the organization's Form 1023, Application for Recognition of Exemption, A described its activities and operational information as follows.

1. A described its past, present and planned activities as follows:

A was formed to provide a stable source of information, advise, and support to inventors and new businesses in the state of F. Its purpose is to provide assistance in any problem areas these entities might encounter. Such areas include idea/product development, advertising, patent and copyright requirements, economic swings and trends, and technical, educational, and emotional obstacles. The corporation believes its endeavors will help bring new businesses and products to F, thereby improving the state's economy.

A provides much of its valuable information to present and prospective members through newsletters and publications. If an individual has a unique problem, A will search for references dealing specifically with that problem. The organization also holds regular meetings in each of its chapters. These meetings provide a creative atmosphere where members can present new ideas, attend workshops obtain information on a specific problem, and hear fellow members' opinions on projects! One major accomplishment that has come from these meetings is a "step-by-step plan" for developing an idea and bringing it to market.

The corporations plans also include starting up chapters all over the state and eventually, the nation. The organization has succeeded in developing many chapters in F, including one at F State

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University. A has also presented many workshops at high schools and vo-techs, hoping to encourage interest in a new group.

One of A's most important activities is the presentation of workshops, seminars, and lectures. This activity lies at the heart of what the organization is attempting to do; it wishes to provide a network of information and assistance to interested parties. A also provides booths at many local fairs to reach the public.

Some of the group's future plans include becoming self-sufficient in order to provide better services, hiring staff and creating a centralized home office, spreading chapters to a national level, and making federal, state, and local governments familiar with its program. A is currently working on a concept called " " which will provide assistance with F state licensing requirements and attract more business to the state.

2. A described its primary source of financial support as follows:

- *Contributions*
- *Membership dues*
- *Fees for seminars/workshops/assistance*
- *Grants (none received to date)*

3. A described its fundraising program as follows:

The organizations program raises a substantial amount of its funds through membership dues, currently set at \$ per year. Members can obtain special "blue card" status by contributing over the \$ amount and "gold card" status with contribution over \$

A currently charges \$ per hour for its arranged workshops and seminars. The organization hopes to obtain additional funding through grants. Individual contributions are also accepted.

The corporation sends out newsletters and publications to prospective members and sets up booths at local fairs, in hopes of obtaining more funding through additional exposure.

In E, based on the information that A provided in its application for exemption and on the assumption that A would operate in the manner represented in its application, A was recognized as a tax-exempt organization described in § 501(c)(3).

Federal Returns

According to IRS record, A did not file Form 990 for the L and for subsequent years. The last return filed by A was for the period ended December 31, .

Operation of A's Down Payment Assistance Program

A, through its promotional materials, advertised its DPA program as follows:

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Thank you for your interest in the Homebuyer "grant" program. A DBA B, a 501(c)(3) non-profit organization administers the Homebuyer grant program in the G area. The program allows you to help your home-buying clients with the assistance of up-front funds to purchase a home.

Included in this package are the following items:

- (a) Program Overview*
- (b) Program Highlights*
- (c) Step-by-step Instructions*
- (d) Grant Application*
- (e) Real Estate Contract Addendum*
- (f) Sample Gift Letter*
- (g) Tips on Processing Loans*

In addition, we have put together Homebuyer information packets designed for your Realtors showing them how they can use the program to create more closings.

A explained how the down payment assistance program worked as follows:

- 1. The Seller or Builder of the home being purchased pays a service fee to B for their services.*
- 2. The fee is a percentage of the sales price of the home. The fee is based on how much cash the buyer needs to get into the home plus 1% of the sales price up to \$1,000. For example, if the buyer needs a grant of 3% for his down payment, the seller would donate a 4% service fee to the B.*
- 3. At closing the Buyer receives a "grant" from the B from an existing pool of funds.*
- 4. After closing, the Seller pays the service fee to the B (this will be done by the Title Company).*

The funds are used to replenish the pool of money for future grants. The availability of the "grant" can increase their pool of potential buyers, and their bottom-line net is comparable to a traditional sale.

The following detail A's program instructions to the lenders, real estate agents, and closing agents as follows:

- 1. The lender fills out the Grant Application and is then faxed to B along with the Real Estate Contract Addendum. Once B received these forms, the transaction is entered into a database.*
- 2. The Realtor ensures that the Real Estate Contract Addendum are filled out and signed by the Seller/Builder and the Buyer at the time of contract ratification. The Addendum is then forwarded to the Lender. The service fee paid by the Seller will be a combination of the grant amount plus 1% of the sales price. For example, if the grant amount needed by the Buyer were \$3,000, the service fee would be \$3,000 + 1% of the sales price.*
- 3. The gift letter for the Buyer is prepared and faxed to the lender by B.*
- 4. Loan is approved and lender notifies B of target closing date. Closing Instructions are faxed to the Title Company and Grant Funds can be wired from B to the Title Company upon review and approval of estimated settlement statements.*

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5. Closing occurs.

Through A's DPA program, buyers receive a "gift" of the funds that they use for the down payment. A house buyer was eligible to participate in A's DPA program only if the buyer purchased a house from a seller that agreed to A's contractual terms. A and sellers entered into agreements that required sellers to pay A an amount equal to the down payment "gift" that the buyer received under A's DPA program. In addition, A charges the seller a service fee of 1% of the sales price up to \$1,000.

On its contract with each seller, A labeled the seller's payment to A as both a "gift" and a "contribution". These contracts obligate the seller, in consideration for participating in A's program, to pay A an amount equal to the amount of the DPA received by the buyer.

Moreover, builders and realtors are solicited to participate in A's Homebuyers "Grant" Program. The promotional materials state "either you use The B Home Buyer Program now and increase your opportunity to sell faster or don't use it and wait for a buyer who has all the down payment and closing costs. Either way, you end up at relatively the same bottom line. So why not use the program and benefit from the increased marketing and exposure".

Sellers are also enticed to participate in the program. A promotes the following benefit to the seller "the availability of the 'grant' can increase their pool of potential buyers, and their bottom-line net is comparable to a traditional sale".

According to H, President, B was a spin off of A. Per Mr. H, the organization ran two programs. A ran the invention, patent, and copyright program, while B ran the DPA program. A's invention/patent program has been inactive since _____ year. Mr. H has been depositing money in the bank account (less than \$ _____) to keep the account active. A's DPA program, according to I (Vice President), started in the year _____. For the years _____, A's DPA program revenue averaged about \$ _____ per transaction. There were 90 transactions amounting to approximately \$ _____ in revenue. B used A's nonprofit status to run its DPA program.

The below information were taken from B bank statements, account number J, showing the income received from its DPA program for the L. Bank Statements for September to December were not provided.

<u>Statement Period</u>	<u>Total amount of deposit</u>
1/1/ - 1/31/	\$
2/3/ -- 2/28.	\$
3/3/ - 3/31/	\$
4/1/ - 4/30/	\$
5/1/ - 5/31/	\$
6/2/ - 6/30/	\$
7/1/ - 7/31/	\$

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8/1/ – 8/31/ \$ _____
Total \$

The below information were taken from A's bank statements, account number K, showing income received from its regular program for the L.

<u>Statement Period</u>	<u>Total amount of deposit</u>
12/26/ – 1/27/	\$
1/28/ – 2/26/	\$
2/27/ – 3/25/	\$
3/26/ – 4/23/	\$
4/24/ – 5/23/	\$
5/27/ – 6/24/	\$
6/25/ – 7/24/	\$
7/25/ – 8/25/	\$
8/26/ – 9/24/	\$
9/25/ – 10/24/	\$
10/27/ – 11/26/	\$ _____
Total	\$

The below information were taken from A's bank statements, account number M, showing income received from its regular program for the L.

<u>Statement Period</u>	<u>Total amount deposited</u>
2/4/	\$
3/4/	\$
4/1/	\$
5/6/	\$
6/3/	\$
12/2/	\$ _____
Total	\$

Law

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

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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 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

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to adopt a woman's child sponsored the care financially. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in § 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

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

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

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.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:

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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. 2006-27, discussed three situations of organizations providing financial help to low-income home buyers and whether each qualified as charitable within the meaning of § 501(c)(3).

Situation 1 described an organization (x) formed to help low-income families purchase decent, safe and sanitary homes throughout the metropolitan area in which x was located. x made assistance available exclusively to low-income individuals and families to provide all or part of the funds they need to make a down payment on the purchase of a home. X used standards set by Federal housing statutes and administered by HUD to determine who is low-income. x offered financial counseling seminars and conducted other educational activities to help prepare the potential low-income home buyers for the responsibility of home ownership. x would require a home inspection report for the property that the applicant intended to buy to ensure the house is habitable before making the grant. To fund its down payment assistance program and other activities, x conducted a broad based fundraising program that attracted gifts, grants, and contributions from several foundations, businesses and the general public. X's staff did not know the identity of the party selling the home to the grant applicant or identities of any other parties such as real estate agents, or developers, who may have received a financial benefit from the sale. Further, x did not accept any contributions contingent on the sale of a particular property or properties. The revenue ruling held that by providing financial assistance to low-income families for the down payment on a home, the organization relieved the poor and distressed.

Situation 2 Y is a nonprofit corporation that is like X in all respects as set forth in Situation 1, except as follows. Under Y's grant making procedures, Y's staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the sale. Moreover, in substantially all of the cases in which Y provides down payment assistance to a home buyer, Y receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by Y in connection with each of these transactions and the amount of the home seller's payment to Y. Finally, Y does not conduct a broad based fundraising campaign to attract financial support. Rather, most of Y's support comes from home sellers and real estate-related businesses that may benefit from the sale of homes to buyers who receive Y's down payment assistance. Y's reliance on the seller's payments for most of its funding indicate that the benefit to the home seller

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is a critical aspect of Y's operations. In this respect, Y is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any educational or charitable purpose. Y does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

Situation 3 Z is a nonprofit corporation formed to combat community deterioration in an economically depressed area that has suffered a major loss of population and jobs. Studies have shown that the average income in the area is below the median level for the State. Z cooperates with government agencies and community groups to develop an overall plan to attract new businesses to the area and to provide stable sources of decent, safe and sanitary housing for the area residents without relocating them outside the area. As part of the renewal project, Z receives funding from government agencies to build affordable housing units for sale to low and moderate-income families. As a substantial part of its activities, Z makes down payment assistance available to eligible home buyers who wish to purchase the newly-constructed units from Z. Z also offers financial counseling seminars and conducts other educational activities to help prepare potential low and moderate-income home buyers for the responsibility of home ownership.

To fund its down payment assistance program and other activities, Z conducts a broad based fundraising program that attracts gifts, grants and contributions from several foundations, businesses and the general public.

In Situation 3, although Z does not limit its down payment assistance program to low-income recipients, Z's down payment assistance program still serves a charitable purpose described in § 501(c)(3) because it combats community deterioration in a specific, economically depressed area that has suffered a major loss of population and jobs. Z is operated exclusively for charitable purposes, Z qualifies for exemption from federal taxation as an organization described in § 501(c)(3).

Down payment assistance payments for home buyers in Situations 1 and 3 are made by those organizations out of a detached and disinterested generosity and from charitable or like impulse, rather than to fulfill any moral or legal duty, and thus qualify for exclusion from such home buyers' gross incomes as "gifts" under § 102.

In Situation 2, in substantially all of the cases in which Y provides down payment assistance to a home buyer, Y receives a payment from the home seller that directly correlates to the amount of the down payment assistance Y provides to the home buyer. In those cases, the payments received by the home buyers do not qualify for exclusion from gross income as gifts under § 102.

Unlike in Situations 1 and 3, in Situation 2, the down payment assistance received by those home buyers represents a rebate or purchase price reduction. As a rebate or purchase price reduction, the down payment assistance is not includible in a home buyer's gross income under § 61 and the

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amount of the down payment assistance is not included in the home buyer's cost basis under § 1012, as adjusted under § 1016.

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

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

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

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

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

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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.

Effective date of revocation

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

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

Government's Position

Based on information provided by A, we conclude that A is not operated for exempt purposes as described in I.R.C. § 501(c)(3). 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, educational, or other exempt purposes. Among other things, A must demonstrate conclusively that the organization meets the operational test of *section 1.501(c)(3)-1(c) of the regulations*. The gathered information indicated that A's primary activity 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. A 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.

A's down payment assistance program does not serve exclusively low-income persons. Instead, A's program is open to anyone without any income limitations who otherwise qualified for a mortgage. Accordingly, A's activities do not serve the purpose of relieving the poor and the distressed within the meaning of section 501(c)(3).

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A has not demonstrated that its down payment assistance program exclusively serves any other exempt purpose within the meaning of section 501(c)(3). Accordingly, A's activities do not serve an educational purpose within the meaning of section 501(c)(3). A has not demonstrated that its program is designed to attract a mixed-income or mixed-race group of homeowners to a specifically defined geographical area that has a history of racial problems or other neighborhood tensions. See *Rev. Rul. 70-585*, Situations 2 and 3. Thus, A's activities do not serve the purpose of lessening neighborhood tensions or eliminating prejudice and discrimination within the meaning of section 501(c)(3). A's program does not limit assistance to certain geographic areas or target those areas experiencing deterioration. See *Rev. Rul. 70-585*, Situation 4. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage, regardless of the location of the property. 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*. Accordingly, A's activities do not serve the purpose of combating community deterioration within the meaning of section 501(c)(3).

The transactions described in A's promotional materials resulted in a circular flow of the money. The sellers make payments to A. A provided the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller's home. The seller's payment was used to replenish the pool of funds that was used to provide "gifts" to subsequent buyers. Because the amount of the "contributions" were directly related to the amount of the down payment assistance provided to the buyers plus the service fee, the actual source of the down payment assistance is the seller's "contribution."

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in *Better Business Bureau of Washington D.C., Inc. v. United States*, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

Like the organization considered in *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989), A is structured and operated to assist the private parties who fund it and give it business. Sellers who participated in A's DPA program benefited 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 benefited 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. Real estate professionals who participate in A's DPA program, from real estate brokers to escrow companies, benefited from increased sales volume. It is evident from the foregoing that A's DPA program provided ample private benefit to the various parties in each home sale.

A's down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, A relies exclusively on sellers and other real-estate related

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businesses that stand to benefit from the transactions it facilitates. A does not appear to receive funds from any other sources.

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), A's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. A provided services to home sellers for which it charged a fee. A did not receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in American Campaign Academy, supra, and Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.) a substantial part of A's activities furthered commercial rather than exempt purposes.

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

The government proposes revoking A's exemption because the organization operated in a manner materially different from that represented in its application for exemption. In its application for exemption signed under penalties of perjury on N, A represented that it was "*formed to provide a stable source of information, advise, and support to inventors and new businesses in the state of F. Its purpose is to provide assistance in any problem areas these entities might encounter. Such areas include idea/product development, advertising, patent and copyright requirements, economic swings and trends, and technical, educational, and emotional obstacles. The corporation believes its endeavors will help bring new businesses and products to F, thereby improving the state's economy*". A does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The records provided by A did not include data on the buyers' incomes and gave no indication that A screened on such data. Rather, A's DPA program provided "gifts" to any homebuyers who qualified for a loan. 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.

Additionally, in GAO-05-194 report to congress, *Mortgage Financing: Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products*, the report analyzed the importance of loan-to-value (LTV) ratios and credit scores and how it attributed significantly to loan performance and its results on the performance of low and no down payment mortgages supported by FHA.

Taxpayer's Position

A will be allowed 30 days to review this report and respond.

Conclusion

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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. A's DPA program is not operated in accordance with Internal Revenue Code § 501(c)(3) and the regulations thereunder governing qualification for tax exemption under Code. A provided down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home.

A operated in a manner indistinguishable from a commercial enterprise. A's primary activity is brokering transactions to facilitate the selling of homes. A's primary goal was to maximize the fees from these transactions. Because A's primary activity was not conducted in a manner designed to further § 501(c)(3) purposes, A was not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

A provides down payment assistance in the form of a gift, to individuals and families for the purchase of a home. A offers its down payment assistance to interested buyers regardless of the buyers' income levels or need. A's DPA activities do not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

Because A's primary activity is not conducted in a manner designed to further § 501(c)(3) purposes, A is not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

Accordingly, the organization's exempt status is revoked effective O.

Form 1120 returns should be filed for the tax periods after P.