



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE: EO Examination
1100 Commerce Street
Dallas, TX 75242

Number: **200749025**

Release Date: 12/7/2007

UIL:501.03-01

Legend

O = organization

D = date

Date: September 7, 2007

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN:

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT:

Dear _____ :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c) (3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501 (c) (3) of the code is hereby revoked effective D.

Our adverse determination was made for the following reasons:

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 a 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).

You failed to meet the requirements of IRC section 501(c) (3) and Treas. Reg. section 1.501 (c) (3) -1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for the benefit of private interests and a part of your net earnings inured to the benefit of outsiders, your founder and board members...

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 the year ending, and for all years thereafter.

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 initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment 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 also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance, or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling () , or writing to: Internal Revenue Service, Taxpayer Advocates

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

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

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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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Taxpayer Identification Number:

Form:
990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:
Telephone: ()
Fax: ()

O

Certified Mail - Return Receipt Requested

Dear , :

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

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

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

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

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

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

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

Internal Revenue Service
Local Taxpayer Advocate Office

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,

Internal Revenue Agent

Enclosures:
Publication 892
Publication 3498
Report of Examination

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

Redaction Legend

O = organization
A1 = address 1
A2 = address 2
YD = year end date
D1 = Director 1
D2 = Director 2
C = Chairman
T = Date operations ceased

Issue

Whether an organization, whose primary purpose is operating a "seller funded down payment assistance" programs is operated exclusively for charitable purposes within the meaning of Internal Revenue Code Section 501(c)(3)?

Facts

O was recognized as an organization exempt under Section 501(c)(3) of the Internal Revenue Code . The organization was incorporated in the State as a non-profit corporation .

The website for the Secretary of State shows the organization as being administratively dissolved as of 12/22/2006. The mailing address shown was A1. IRS records show the organization address as A2.

Correspondence was sent to the IRS address of record, notifying O of an examination of the organization for the tax period ended YD. The letter was to request records to determine how O Foundation down payment assistance program operated. No response was received.

On the organization's Form 990, D1 and D2 was shown as the Directors, C as the Board Chairman of the organization, with D1 as the signer of the return. A telephone call was made to D1. D1 responded to the phone call. Another telephone call was made to D1. D1 had indicated that the organization went out of business in T, when Revenue Ruling 2006-27 was released. D1 also mentioned that the organization did not receive the correspondence that was previously mailed . D1 gave the following contact information: cell phone number , fax number and current address of A2.

Another copy of Letter 3606, IDR, and Publication 1 was faxed to the provided fax # . On D1 confirmed receipt of faxed IDR. The Internal Revenue Agent received the following faxed copies from the organization: 1) Articles of Incorporation, 2) Bylaws, 3) Form 1023 application, and 4) Determination Letter. The cover letter to the fax stated that D1 would follow-up with other requested documents.

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A follow-up call was made to D1 concerning the rest of the requested documents. No response was received.

According to the organization's Form 1023, Application for Recognition of Exemption, the following was its primary activity:

1. *To increase homeownership and expand the supply of safe and affordable housing for low- and moderate-income persons, thereby providing relief for the poor and distressed and lessening the burdens of government agencies.*
2. *O will increase homeownership and assist the poor by administering a down payment assistance program (DAP). The DAP will assist low- and moderate-income individuals and families purchase homes by making a charitable grant at closing to each qualified buyer. The grant – which need not be repaid- will be used to pay for the buyer's down payment, closing costs, or prepaid expenses, as needed. In turn, the seller will be charged a service fee at closing in return for O's efforts to identify, educate, and assist prospective buyers and for promoting the seller's home. The service fee will be allocated to a pooled fund of grants and fees, which will then be used to provide down payment assistance to subsequent homebuyers. O has not yet established the amount of the service fee, but it will be approximately one percent of the home's sale price.*
3. *O's efforts will be targeted primarily at first-time homebuyers using mortgages insured by the FHA.*
4. *O will also contract with one or more marketing organizations to promote its services.*

The Internal Revenue Service Determination Specialist requested a signed agreement from D1 with respect to Declaration of Compliance with Revenue Procedure 96-32 (Exhibit B).

O filed Form 990 for the calendar year ended YD. In , O's only reported activity consisted of operating its down payment assistance program (DPA) as described in more detail below.

According to Part III of O's Form 990 return, the organization's primary exempt purpose was to "increase homeownership and expand the supply of safe and affordable housing for low and moderate income persons, thereby providing relief". Part III further described O's tax-exempt purpose as follows:

- (a) *home buyer down payment assistance program aided in over 200 homes purchased by low income persons.*
- (b) *voluntary contributions rec. as a pass through from home sellers to be paid to other unrelated 501(c)(3) organizations.*

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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The grants section of Part III, Form 990, showed grants received of \$ _____ and expenses of \$ _____

O reported \$ _____ in gross revenue. The amount was reported as contributions.

O, through its website (note: website is no longer active), promoted its DPA program to lenders, buyers, sellers, mortgage companies, real estate agents, and builders. O's website explained how the down payment assistance program worked as follows.

1. The seller and buyer must agree to participate in O Foundation Down Payment Grant Program. This is done by the seller agreeing to donate funds to O and O providing cash grant to the buyer. The seller contribution was deducted from his proceeds at the time of closing and would be shown as a debit to the seller on the closing agreement and the same amount would be shown as a credit to O Foundation.
2. The sellers and buyers sign the earnest money agreement, donation form, and grant letter and it is then faxed over to O Foundation.
3. On the date of settlement, O Foundation will wire the down payment funds to the lender.

Through O'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 O's DPA program only if the buyer purchased a house from a seller/builder that agreed to O's contractual terms. O and builders/sellers entered into agreements that required sellers to pay O an amount equal to the down payment "gift" that the buyer received under O's DPA program. In addition, O charges the seller/builder a fee of \$ _____ which O referred to as "additional grant contribution".

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

Moreover, builders, lenders and realtors are solicited to participate in O's Down Payment Grant Program. Sellers are also enticed to participate in the program by agreeing to make a contribution to the Down Payment Grant Program.

The references below, from some of O's promotional material, discuss the benefit to each party participating in the program (see exhibit A).

Sellers O advertised that its DPA program financially benefits sellers by providing them with ready buyers, enabling the sellers to sell for higher prices and allowing them to sell faster due to the larger pool of potential buyers, thereby reducing the costs associated with real estate remaining unsold for an extended period.

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Realtors O's promotional materials tell realtors that O's Down Payment Grant Program can help them close more sales and thus increasing their commissions. Additionally, it promoted an increased pool of qualified buyers and a reduction in buyer's cash requirements to close.

Builders O's promotional materials tell builders that O Foundation "helps builders in obtaining full asking price for their homes by offering down payment grants to prospective home buyers." The materials also promoted the down payment program by saying that "this remarkable program allows the builder to offer a home with a free down payment increasing the chances of a quicker sale without the builder needing to make additional concessions".

Additionally, it stipulates that the builder, in return, would "agree to make a 'contribution' back to O. These 'grant contributions' allow O to expand their program for other prospective home buyers." O defined "additional grant donation" as a fee for service. Upon settlement, builders/sellers agree to make an "additional grant contribution" to O Foundation. The fee charged is about \$1,000 per transaction, however, O offers volume based discounts for Builders. The promotional material gives the following example:

Builders Volume Discount Pricing

1 to 20	Annual homes using DPA grants	\$500 per grant
21 to 99	Annual homes using DPA grants	\$450 per grant
Over 100	Annual homes using DPA grants	\$400 per grant

Lenders O's promotional materials tell lenders that "O's Down Payment Grant Program helps you close more loans and get more people into homes."

O has also added an additional benefit called the "value added services". The additional benefit was to allow the loan officers the opportunity to customize each transaction. There are three types of value added services:

1. Charitable donation—O will donate up to \$100 for each grant processed through O to the charity of their choice. O would make the donation out in the loan officer's name.
2. Co-op Advertising---This allowed a loan officer to accrue money in a co-op advertising account with O and it pays for marketing and communication programs that promoted O and the participants company.
3. Low Net Price-\$695 --- This allowed the loan officers to pass along additional savings to the buyer. The additional grant contribution amount is reduced to \$695.

Below are descriptions of the roles of the lenders, builders, and real estate agents in DAP transactions, as indicated on the organization website.

Builders/Realtors

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- The builders agree to participate in the O Foundation Down Payment Grant Program and to donate funds back to the grant program so that it replenishes existing pool of funds.

Lenders

- Calculates the amount of grant needed by the home buyers
- Complete a one-page application form and fax back to O
- Obtain signatures--the seller and buyer signs the earnest money addendum, the seller signs the pledge form. The buyer signs the grant letter.
- Faxes the application form, earnest money agreement, donation form, and grant letter to O.
- O wires the funds on the day of closing

Sellers

- The sellers agree to participate in the O Foundation Down Payment Grant Program and to donate funds back to the grant program so that it replenishes existing pool of funds.
- The seller donation to the grant Program will be deducted at the time of closing.
- The sellers complete the Earnest money addendum and sign the pledge form.

Buyers

- The buyers must be able to qualify for a loan that allows a financial gift to be used as part or all of the down payment.
- Buyers do not need to be first-time homebuyers. Anyone can participate in the program as long as the lender allows it.
- O does not have any income limitations—"We do target low to moderate income families for assistance—but it is not limited by income".
- The buyer is required to solicit pledges for O – "The amount of the pledge the buyer is required to collect is at least the grant amount plus an additional grant contribution (typically \$) to help O Foundation increase the available pool of funds".
- The buyers complete the Earnest money addendum and grant letter.

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).

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

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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 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.

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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:

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.

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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 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).

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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 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

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construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

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

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

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

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption under § 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of § 501(c)(3) and the regulations.

Benefiting Private Interests

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

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

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.).

Section 6001 of the Internal Revenue Code ("Code") provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 6033(a)(1) of the Code provides, except as provided in Section 6033(a)(2), every organization exempt from tax under Section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Section 1.6001-1(a) of the Income Tax Regulations ("Regulations") in conjunction with Regulation Section 1.6001-1(c) provides that every organization exempt from tax under Section 501(a) of the Code and subject to the tax imposed by Section 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by Section 6033.

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Section 1.6001-1(e) of the regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

Section 1.6033-2(i)(2) of the regulations provides that every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of Subchapter F (Section 501 and following), Chapter 1 of Subtitle A of the Code, Section 6033, and Chapter 42 of Subtitle D of the Code. See Section 6001 and §1.6001-1 with respect to the authority of the district directors or directors of service centers to require such additional information and with respect to the books of accounts or records to be kept by such organizations.

Revenue Ruling 59-95, 1959-1 CB 627, concerns an exempt organization that was requested to produce a financial statement and a statement of its operations for a certain year. However, its records were so incomplete that it was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provision of Section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status.

Government's Position

Based on information gathered from www.archive.org regarding O's website, we conclude that O is 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, educational, or other exempt purposes. Among other things, O must demonstrate conclusively that the organization meets the operational test of section 1.501(c)(3)-1(c) of the regulations. The gathered information indicates that O's primary purpose is to operate a down payment assistance program that does not exclusively serve a purpose described in section 501(c)(3) and that furthers a substantial private benefit.

Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of the regulations. O's down payment assistance program does not operate in a manner that establishes that its primary purpose is to address the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1.

O's down payment assistance program does not serve exclusively low-income persons. Instead, O's program is open to anyone without any income limitations who otherwise qualified for a mortgage. O's website showed that "the buyers must only be able to qualify for a loan that allows a financial gift to be used as part or all of the down payment". In addition, O's website stated that

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the buyers do not need to be first-time homebuyers. In its FAQ section, question #6, O responded that "anyone can use it provided your lender allows use of it." Accordingly, O's activities do not serve the purpose of relieving the poor and the distressed within the meaning of section 501(c)(3).

O has not demonstrated that its down payment assistance program exclusively serves any other exempt purpose within the meaning of section 501(c)(3). Accordingly, O's activities do not serve an educational purpose within the meaning of section 501(c)(3). O 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, O's activities do not serve the purpose of lessening neighborhood tensions or eliminating prejudice and discrimination within the meaning of section 501(c)(3). O'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, O's activities do not serve the purpose of combating community deterioration within the meaning of section 501(c)(3).

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in *Better Business Bureau of Washington D.C., Inc. v. United States*, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if O's DPA program were directed to exclusively low-income individuals or disadvantaged communities, O's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989), O is structured and operated to assist the private parties who fund it and give it business. Sellers/builders who participate in O's DPA program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market.

The manner in which O operated its DPA program shows that the private benefit to the various participants in O's activities was the intended outcome of O's operations rather than a mere incident of such operations. O'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, O relies exclusively on sellers/builders and other real-estate related businesses that stand to benefit from the transactions it facilitates. O secures an agreement from the sellers/builders stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless O is assured that the amount of the down payment plus the fee is or will be paid by the seller/builder upon closing. In essence, the sellers/builders make payments through O to homebuyers. By arranging the buyer/seller DPA transactions, O facilitates the sale of the sellers' homes. That O receives a

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payment from the home seller/builder corresponding to the amount of the down payment assistance in every transaction indicates that the benefit to the home seller is not a mere accident but rather an intended outcome of O's operations. In this respect, O is 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.

O's promotional material and its marketing activities show that O operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in § 501(c)(3). The manner in which O operated its DPA program shows that O was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect O's operations were similar to an organization which was denied exemption because it operated a conference center for commercial purposes. See Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003).

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), O's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. O provided services to home sellers/builders for which it charged a fee. O did not market its services primarily to persons within a charitable class. O did not solicit or receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in American Campaign Academy, supra, and Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.) a substantial part of O's activities furthered commercial rather than exempt purposes.

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 (See exhibit C).

Accordingly, O does not qualify as an organization described in I.R.C. § 501(c)(3) because it operates a program that does not exclusively serve an exempt purpose described in section 501(c)(3).

Taxpayer's Position

O's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. O 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. O'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. O provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home.

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

Furthermore, in accordance with the provisions of the Code and Regulations under Sections 6001 and 6003, organizations recognized as exempt from federal income tax must meet certain reporting requirements. These requirements relate to the filing of a complete and accurate annual information (and other required federal tax forms) and the retention of records sufficient to determine whether such entity is operated for the purposes for which it was granted tax-exempt status and to determine its liability for any unrelated business income tax.

The position of the Internal Revenue Service is that O failed to meet the reporting requirements under Sections 6001 and 6033 to be recognized as exempt from federal income tax under Section 501(c)(3) of the Code.

For the foregoing reasons, revocation of exempt status is proposed effective.

Form 1120 returns should be filed for the tax periods.

Exempt Organizations - Report of Examination (Proposed Status Changes)

1. Form No. 990	2. Area Office	3. Date of Report
4. Name and Address of Taxpayer O		5. Employer Identification No.
		6. Tax Period(s) Ending

7. Report Preparer's Name		8. Agreement Secured Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>
9. Findings Discussed with (Name and Title)		10. Agreement Date

11. Current Foundation Status Classification (Enter description and IRC reference.)
501(c)(3) 509(a)(1) and 170(b)(1)(A)(vi).

12. Nature of Proposed Status Change
(*"X" applicable line, enter IRC ref., & effective date*)

X	Revocation of exemption under IRC Section 501(c)(3), effective (date) D
	Modification of exempt status from IRC Section 501(c)() to 501(c)() effective (date)
	Modification of foundation status from current classification shown in item 11 above, to a private non-operating foundation (IRC Section 509(a)), effective (date)
	Modification of foundation status from current classification shown in item 11 above, to an operating foundation (IRC Section 4942(j)(3)), effective (date)
	Modification of foundation status from current classification shown in item 11 above, to an organization described in IRC Section 509(a)(), effective (date)
	Modification of foundation status from current classification shown in item 11 above, to an organization described in IRC Section 509(a)(1) and 170(b)(1)(A)(), effective (date)

13. Remarks

14. Attachments:
F886-A