



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75242

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

January 17, 2008

Number: **200817058**

Release Date: 4/25/2008

LEGEND

ORG = Organization name

XX = Date

UIL: 501.03-01

Address = Address

ORG
ADDRESS

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN:

CERTIFIED MAIL-RETURN RECEIPT REQUESTED

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 January 1, 20XX.

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, you 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.

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 December 31, 20XX, 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.

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 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 Office.

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.

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



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

ORG
ADDRESS

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.

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,

Reatsamay Ly
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 ORG	Tax Identification Number	Year/Period ended December 31,

LEGEND

ORG = Organization name XX = Date CO-1 = Original company
Motto = motto President = President VP = Vice President

Issue

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

Facts

ORG (DBA ORG), hereinafter referred to as "ORG", was recognized as an organization exempt under Section 501(c)(3) of the Internal Revenue Code on February 11, 20XX. The organization was incorporated in the State of XYZ as a non-profit corporation on May 14, 20XX under the name "CO-1". On October 10, 20XX, an amendment to the Articles of Incorporation was filed to operate under the name of "ORG". ORG also filed for a Certificate of Trade Name under the name of "ORG". ORG was to "Motto" for ORG.

The Secretary of State of XYZ web site shows the status of ORG as "delinquent" for failure to file required annual report. Under the trade name for ORG, the web site shows the status of "effective".

On the organization's 20XX Form 990, President and VP were shown as the President and Vice President of the organization, with VP as the signer of the return.

On April 21, 20XX, correspondence was sent to the IRS address of record, notifying ORG of an examination of the organization for the tax period ended December 31, 20XX. The letter was to request records to determine how ORG down payment assistance program operated.

On June 5, 20XX, the above correspondence was returned to the IRS as undeliverable.

On October 30, 20XX, a second Information Document Request (IDR) was mailed to ORG. The correspondence restated the information requested on the April 21, 20XX correspondence.

On November 21, 20XX, a response to the above IDR request was received by the IRS. The organization stated that ORG ceased to operate in mid 20XX because "it became difficult for the organization to receive enough contributions to serve the public."

According to ORG Bylaws, the objectives and purposes of ORG are stated as follows.

1. *Charitable financial aid for first time home buyers to purchase house through donation of all or portion of down payment, by individuals to individuals.*
2. *The goal of the donations is to give a family or individual the ability to purchase a home at a time when house prices are very high and the individual may not have been able to purchase one otherwise.*

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3. *The organization has a goal to donate 95% or more of all donations to first time homebuyers.*
4. *60% of all grant recipients must be in the lowest 20% of income for the area in which they live.*

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

1. *The organization will be receiving donations made by individuals. Proceeds will go directly to people who are in need of a down payment to purchase their first home. Each donation made by the organization will enable a first time home buyer with little or no money to put money down on a house so they can buy it.*
2. *The organization will become active as soon as it gains its 501(c)(3) tax exempt status.*
3. *The organization will conduct operations at its primary place of business and will be operated by its officers and staff.*

On July 17, 20XX, the IRS Specialist wrote to ORG requesting additional information regarding ORG's down payment assistance. On August 8, 20XX, another follow-up request was issued regarding the lack of response to the above correspondence. In addition, the letter requested signature on the Statement Regarding Seller Fees and Declaration of Compliance with Revenue Procedure 96-32 by the appropriate authorized officers.

On October 29, 20XX, ORG responded to the above inquiry. ORG provided the following responses regarding its down payment assistance program:

1. Describe in detail the criteria used in selecting recipients. ORG responded as follows.

In order to be awarded a down payment and closing cost grant the recipient will have to show financial need. The criteria will include, but will not be limited to financial need, and lack of down payment and closing costs. The loan processor who is qualifying the loan will determine if the applicant will qualify for a grant. The loan processor will then submit a grant application to

2. Describe the qualification of your selection committee. ORG responded as follows.

All members of the selection committee are required to have an unbiased perspective at who will receive the grant. They must have no interest in who receives the grant except to see that the money betters the community. The selection committee is made up of President, and VP. The selection committee will expand to have five members, when the non-profit becomes fully operational.

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3. Are members of the selection committee or their relatives eligible to apply? If so, please describe the procedures you follow to ensure an unbiased selection. ORG responded as follows.

Members of the selection committee are eligible to receive grants only if all other applicants have been granted and the member will not be allowed to participate in the decision.

4. Indicate the approximate number of down payments for first time homeowners awarded annually. ORG responded as follows.

does not turn away anyone that meets our qualifications. Our qualifications consist of maximum \$ a year income and maximum of \$ in their bank account, and are in need of a down payment to purchase a home. Annually we hope to award anywhere from to grants a year.

5. Give the approximate number of individuals eligible to apply annually. ORG responded as follows.

There is no limit on the amount of individuals eligible to apply.

6. Describe the procedures you follow to monitor grant funds. ORG responded as follows.

only issues grant checks to title companies on the scheduled closing date. The mortgage company, title company and home buyer are properly notified of this. Then checks after the closing that all funds were used properly.

7. Describe the procedures you follow if you discover a misuse of funds. ORG responded as follows.

audits the books monthly to ensure all money is accounted for. would use every resource needed to recover the funds. Also due to follow up of any misuse of funds would be discovered immediately and the check would be stopped.

8. Furnish a description of your organization's staff, their experience and/or qualifications for the functions, which they will perform. How will they be compensated for their services? What amount of compensation will they receive and how is the amount determined? ORG responded as follows.

The organization will consist of a grant selection committee which will select and process all applications. Also they will be down payment promoters who are responsible for promoting the availability of down payment grants and also to receive donations. Finally another staff member will be responsible for keeping track of the books and following up on grants as they are distributed. They will be compensated

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on the actions they perform, their productivity and their hours worked. Any salaried position will be voted on by the board of directors.

9. Are the sellers of the homes required to donate a percent of the sell of the home to your organization? If so, what percent? ORG responded as follows.

The sellers are not required to donate a percentage of the sale to the organization. There is a fee which is less than one half of a percent of the average house price in the area.

The Internal Revenue Specialist requested a signed agreement from ORG for a favorable determination letter. The agreement stated that ORG would not require the sellers to pay a fee or donate to participate in ORG's down payment assistance program. In addition, a Declaration of Compliance with Revenue Procedure 96-32 was also signed.

On February 11, 20XX, based on the information that ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, ORG was recognized as a tax-exempt organization described in § 501(c)(3).

ORG filed Form 990 for the calendar year ended December 31, 20XX. In 20XX, only reported activity consisted of operating its down payment assistance program (DPA), as described in more detail below.

According to Part III of the ORG 20XX Form 990 return, the organization's primary exempt purpose was to "provide down payment and closing cost assistance to home buyers who could otherwise not afford to participate". The grants section of Part III, Form 990, shows grants and allocations of \$.

In 20XX, ORG reported \$ in gross revenue. The amount was reported under Program service revenue rather than as contributions.

ORG provided pamphlets, flyers, information from its website and program information concerning ORG, Inc., a trade name of ORG. According to the pamphlets, ORG, Inc. was the exclusive marketing agent of ORG and its charter stated that "80% of all participants must come from a protected class, either a low income family or a minority". ORG, Inc. described its DPA program as follows.

1. *Lender completes on-line grant application, including the grant amount which details how much money the buyer will need to close.*
2. *The lender then receives a gift letter from ORG which is all the documentation the lender needs to include in the loan package. The gift letter states the buyers name, property address, the grant amount, and ORG's tax ID number.*

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3. *The real estate transaction is negotiated between the buyer and seller in which the seller agrees to contribute to ORG in the amount of the grant + the seller service fee.*
4. *Before the closing ORG will either send a wire or a certified check to the appropriate closing agency.*
5. *The seller contribution to ORG is collected at the closing. (According to the IRS ruling the seller is receiving the full benefit of the donation through the sale of the home and therefore the contribution is not considered a "Charitable" tax deduction).*
6. *ORG receives the seller's contribution at the closing and the transaction is complete.*

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

- The seller or builder of the home being purchased must make a contribution to ORG in the amount of the grant needed plus ORG fee.
- At closing, the buyer receives a gift from ORG to cover their down payment and closing costs.
- After closing, the seller makes a contribution to ORG in the amount of the grant plus ORG fee, and the pool of funds is replenished for future home buyers.
- ORG works directly with title companies to arrange wiring for funds.
- After closing ORG does a follow up to ensure funds were disbursed properly.

Through ORG's DPA program, buyers receive a "gift" of the funds that they use for the down payment. ORG and sellers entered into agreements that required sellers to pay ORG an amount equal to the down payment "gift" that the buyer received under ORG's DPA program. Per VP, Director, indicated that ORG charges the seller a service fee of \$-\$. In 20XX, the service fee charged was about \$.

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

Moreover, builders, lenders and realtors are solicited to participate in ORG's Down Payment Grant Program. ORG's promotional materials tell realtors, builders, and lenders that Down Payment Assistance Program can help them close more sales and thus increasing their commissions. The promotional material states that the ORG program will increase the number of potential home buyers by 30%. Additionally, it stated that "with ORG's Down Payment Assistance

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Program anyone using an FHA, Conventional, or Sub-prime loan may receive gift funds for down payment and closing costs”.

Sellers are also enticed to participate in the program by agreeing to make a contribution to the DPA program, plus a service fee, so that it replenishes existing pool of funds. ORG advertised that its DPA program can assist sellers in getting full asking price and sell their home faster. The seller’s donation to the grant program will be deducted at the time of closing.

Buyer participation in the DPA program required no income limitations—“any qualified buyer can receive a gift regardless of income”. Gift funds are available up to \$.

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 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.

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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.

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.

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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., 20XX), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

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

See also, Living Faith Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for substantial commercial purposes and not for exclusively exempt purposes).

Rev. Rul. 20XX-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

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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 indicates 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).

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

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

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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.

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. 20XX-4, §14.01

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(cross-referencing §13.01 et seq.), 20XX-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. 20XX-4, § 14.01 (cross-referencing § 13.01 et seq.).

Government's Position

ORG does not qualify as an organization described in IRC § 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), and (2) provides substantial private benefit to persons who do not belong to a charitable class, the home sellers.

The transactions described result in a circular flow of the money. The sellers made payments to ORG. ORG provided the funds to the buyers, who used 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 were used to provide "gifts" to subsequent buyers. ORG did not have any other source of funds other than "contributions" from sellers and related fees. 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 was 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. ORG'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 was operated for the substantial purpose of benefiting private parties.

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 B).

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Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participated in ORG'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 participated in ORG's DPA program, from real estate brokers to escrow companies, benefited from increased sales volume.

ORG'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, ORG relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates. ORG does not appear to receive funds from any other sources.

ORG requires the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus a service fee. ORG secures an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless ORG was assured that the amount of the down payment plus the fee was paid by the seller upon closing. In this respect, ORG is like the organization considered in Easter House which provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially.

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), ORG's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. ORG provided services to home sellers for which it charged a market rate fee. ORG did not 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 ORG's activities furthered commercial rather than exempt purposes.

Despite the representations in its application for exemption, ORG did not enforce any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The electronic records provided by ORG as well as promotional materials did not include data on the buyers' incomes and gave no indication that ORG screened on such data. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan.

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

Taxpayer's Position

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

Conclusion

In order to qualify for exemption under IRC § 501(c)(3) an organization must be both organized and operated exclusively to achieve a purpose that is described under that Code section. ORG's DPA program is not operated in accordance with IRC § 501(c)(3) and the regulations there under.

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

Accordingly, the organization's exempt status is revoked effective January 1, 20XX.

Form 1120 returns should be filed for the tax periods after December 31, 20XX.