



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TE/GE – EO Mandatory Review  
1100 Commerce Street, MC 4920-DAL  
Dallas, TX 75242

UIL: 501.03-01

Release Number: **200822030**

Release Date: 5/30/08

Legend

Org= Organization name

Date: February 21, 2008

Org

Address

XX = Date

Address = Address

Employer Identification Number:

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer To:

TE/GE Review Staff

**LAST DAY FOR FILING A  
PETITION WITH TAX COURT:**

May 22, 20XX

**CERTIFIED MAIL – Return Receipt Requested**

Dear :

This is a Final Adverse Determination revoking your exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

ORG has failed to provide evidence you are currently operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). You are not a charitable organization within the meaning of Treasury Regulations 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. You did not respond to our request for documentation to substantiate your activities and fiscal operations.

Based upon the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code retroactively to July 1, 20XX.

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

You are required to file Federal income tax return Form 1120. These returns should be filed with the appropriate Internal Revenue Campus for the year ending June 30, 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 91<sup>st</sup> 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 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax exempt status was determined by calling \_\_\_\_\_, faxing \_\_\_\_\_, or writing to: Internal Revenue Service, Taxpayer Advocates Office.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals process, 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,

Marsha A. Ramirez  
Director, EO Examinations

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer <b>ORG</b>		Year/Period Ended 20XX06

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 company, CO-2 = 2<sup>nd</sup> company, CO-3 = 3<sup>rd</sup> company, CO-4 = 4<sup>th</sup> company, CO-5 = 5<sup>th</sup>  
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**ISSUES**

Whether the ORG exempt status under I.R.C. § 501(c)(3) should be revoked because:

1. ORG has not submitted additional information as may be required for purposes of inquiring into the organization's exempt status.
2. ORG has more than an insubstantial part of its activities not furthering exempt purposes, but rather furthering a commercial purpose.
3. ORG has not established that it operates to serve public interests, but rather serves the private interests of real estate professionals.

**FACTS**

**Overview**

ORG (ORG) is a not-for-profit corporation formed under the laws of the State of XYZ effective on March 15, 19XX. Registered Agent is ORG's registered agent. ORG's address is Address City, XYZ.

**Application for Recognition of Tax-Exempt Status**

On August 8, 19XX the Service received ORG's Form 1023, application for recognition as a tax-exempt organization under I.R.C. § 501(c)(3). The Service requested subsequent information of ORG's activities to complete the process of determination of exempt status.

The Service administrative files retained recordation of ORG's Form 1023 and requested attachments. ORG's application stated that its activities were the acquisition, rehabilitation, and sale of residential properties in urban areas designated by government agencies for development grants. Activities included providing down payment assistance as well as advice and training in property maintenance to prevent future deterioration of the properties and communities. The purpose was to combat community deterioration in distressed urban areas and provide DPA to needy renters. The bulk of the home purchasers will be low-income individuals and families and efforts to sell at least 75% of the units to buyers with incomes below 80% of the area's median income, and to sell at least 50% to buyers with incomes below 50% of the median income. Form 1023 provided that downpayment assistance will be provided in the form of an "outright grant".

Sources of financial support would be from private contributions, government grants, income from sales of property, investment income and fees from management, education, and

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consulting services required for home ownership. All of the applicant's income will be devoted to acquiring and rehabilitating property in designated urban areas.

On November 03, 19XX, the Service issued a determination letter recognizing ORG as a tax-exempt organization described in § 501(c)(3) of March 15, 19XX. The Service's determination letter also determined that the organization would initially be considered, pursuant to an advance ruling period, as an organization which is not a private foundation under sections 509(a)(1) and 170(b)(1)(A)(vi) because the organization could reasonably expect to attract enough public support to meet the public support tests. The determination was based on the assumption that ORG would operate in the manner represented in its application, Form 1023 and attachments. On July 10, 20XX ORG was determined to be an organization described in Section 509(a)(2).

**Federal Returns**

ORG filed Forms 990 for tax periods June 30, 19XX through June 30, 19XX. Although the total revenue for 19XX was far beyond the filing requirement amount, no other Forms 990 were filed for subsequent years.

The final Form 990 filed, for 19XX, reported program service revenue of \$ and gross rents of \$; and total assets were listed as \$. ORG reported rental income and program service revenue from ORG activities. No contributions, public support, or government contributions were received. All expenses, including advertising expenses, listed on Form 990 appeared incurred from ORG DPA activities.

According to Part III, of ORG's 19XX Form 990, ORG's purpose was to "assist low and moderate income families to acquire homes." Part VIII of the return states that "Income from the sale of affordable housing provided underserved families the financial assistance needed to achieve home ownership and their communities with the stability that comes from having residents who are invested in, and committed to, their neighborhoods"

No other returns have been filed by ORG.

**General Activities:**

Internet website information shows that since 20XX ORG has promoted and operated a down payment assistance (DPA) program for house buyers under which it provides funds to the buyers to use as their down payment or for closing costs and collects the same amount, plus an additional fee, from the house sellers. As more fully described below, under ORG's

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program, down payment assistance is provided for all types of housing loan programs, including federally insured mortgages to buyers, whether first time or not, and without any income or asset limitations.

**Failure to Respond**

The Internal Revenue Service issued correspondence on April 4, 20XX requesting that ORG provide documentation of its activities for tax period ending June 30, 20XX. This was issued to the Service’s address of record. As no reply was received, the Internal Revenue Service issued an additional request to the address shown on ORG website using certified mail on February 14, 20XX; and, the Service issued a request for information to the address shown on the Service’s records using certified mail on June 20, 20XX. ORG failed to respond to the Internal Revenue Service’s correspondence or file Form 990 for the tax period ending June 30, 20XX. Postal tracers, Form 4759, were processed for both addresses on June 20, 20XX. All certified mail was returned as undeliverable and the postal tracers produced no forwarding address.

As ORG did not respond to Internal Revenue Service’s request for information and the Service was unable to locate ORG, no explanation of its activities was provided by letter or in person; however, information on the organization’s activities was available on the internet (at ORG’s website and ORG’s archived 20XX website at. The website information was posted by ORG, and as such, it is considered reliable information and is utilized within this report to document activities of ORG. Copies of the website pages (20 pages printed on May 3, 20XX and June 4, 20XX) were mailed to the organization for comment on June 20, 20XX. Four pages are shown as Attachment 1.

**Operation of ORG’s Down Payment Assistance Program**

ORG paid for advertising and utilized its website to promote its DPA program to buyers, real-estate professionals, and sellers. Many of the participants in ORG’s program utilize Federal Housing Administration (FHA) financing for their home purchase. To qualify for a federally insured mortgage, a buyer must make a down payment in a specified minimum amount, generally equal to 3% of the purchase price. To qualify under applicable Department of Housing and Urban Development (HUD) rules, such a buyer may only receive gifts to use for the down payment from a relative, employer, labor union, charitable organization, close friend, governmental agency, or public entity. The seller cannot loan money to the buyer for the down payment. See Attachment 2 and 3 for (respectively) the U.S. Government Accountability Office (GAO) report on Mortgage Financing dated February 20XX (GAO-05-194) and the GAO report on Mortgage Financing dated November 20XX (GAO-06-24).

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ORG provided resources to assist in credit repair, downpayment assistance, financing, homebuyer education and the ORG "gift program.

As shown on their archived 20XX website, ORG charges the seller a fee for each property sold. This fee is equal to the "gift" amount plus a fee.

Within ORG's own description of transaction requirements for the DPA on it's archived 20XX website ORG confirms that the seller must pay the gift amount, to participate. The first step of the DPA program is to obtain a signed agreement that the seller will pay the gift amount plus a percentage before ORG issues payment.

ORG's 20XX archived website pages contain its ORG Participating Home Agreement form; on this form paragraph #2 has one place to insert an amount. This section states in part: "Seller agrees to pay ORG a service fee in the amount of \$ for the aforementioned services at closing of the transfer of the Participating Home to the Buyer." (emphasis supplied)

The amount to be entered on in paragraph #2 is explained on ORG's 20XX archived webpage downloadable forms on the "Instruction Sheet" that provides the following instructions:

- 1) Fax the following to ORG once the sales contract has been executed:
  - Grant application
  - ORG Participating Home Agreement- relative to the gift amounts and the fee to be paid by the seller, select the amount that you need for the gift and add \_\_\_% of the sales price to the gift amount to arrive at the fee to insert in paragraph 2 of the Participating Home agreement.
- 2) ORG will fax back the copy of the Gift Letter and mail you an original.
- 3) When available, fax to ORG the Escrow/Title Company Closing Office Information form, and a copy of the lender's clearance to close.
- 4) ORG will confirm the closing date and overnight a cashiers' check and closing instructions to the title company for receipt the day before closing.  
(emphasis supplied)

Thus, ORG's archived website pages show that the seller pays the exact amount of the gift plus \_\_\_% of the sales price to participate in the program. The website shows that the first step in the process was to secure a signed statement of the sellers commitment to pay the amount of the gift, plus a fee, and this is done before ORG sends the cashier's check to the title company.

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The sellers make payments to . ORG provides the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller's home.

The website's description under "about us" begins by stating that ORG is a non-profit 501(c)(3) charitable organization and provides its tax ID number. And the first line of the "gift" application states that ORG is a non-profit association.

On their website or elsewhere, ORG does not solicit outside public contributions or indicate any other source of funds other than fees from sellers and related fees.

**Website:**

The 20XX archived website pages secured from "http://" on May 03, 20XX state that ORG is an experienced non-profit affordable housing provider whose staff has helped over 30,000 families successfully obtain home ownership over the last 30 years. ORG's mission is to help the underserved low and moderate income individuals obtain housing. ORG offers programs to assist the homebuyer with down payment assistance and credit repair.

ORG claims it will find an affordable property that fits into ORG guidelines, and will obtain closing cost assistance.

The ORG guidelines require the buyer to complete education on home ownership, invest \$ and purchase a qualified home. Gifts/grants are for low and moderate income and undeserved areas. Individuals must occupy the home with income not exceeding 115% of the median income for the area. ORG will purchase the home, complete repairs, and sell the property to the client through an assumption of the existing FHA mortgage or using a 203(b) loan through the Lender Community Partner. The program may not be used for new homes purchased from builders.

There were no restrictions on locations or limits to target homes in specific neighborhoods or geographical areas.

Prints of ORG's website were submitted by the Service to ORG for ORG's comment on June 20, 20XX. No reply was received.

**Income Level:**

Despite the ORG's representations that the gift program is designed for "low to moderate" income individuals, ORG does not apply income limitations for its ORG program. To the contrary, ORG specifically states that the buyer's income field of the gift application is for

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“statistical purposes”. And no information supported that ORG screened qualified participants based on income level data.

ORG defines “Qualified Homebuyer” and includes no income level restrictions within this description as shown below. Under who qualifies; “qualified homebuyers” are defined as follows:

- Use of an eligible loan program
- Completion of home ownership education
- Minimum investment of at least \$
- Purchase of a qualifying home

**Advertising and Real Estate Professionals Activities:**

ORG website includes information on resources which begins with advertising of and links to the following commercial companies: CO-1 (CO-1); CO-2; CO-3 (for big savings from you favorite stores, online merchants, restaurants, and travel companies); CO-4; and CO-5.

The archived website (secured from “http:// ” on June 04, 20XX) state that ORG states “Home buyers and professionals will find our site to be user friendly and full of helpful information” and “If you are a realtor professional, contact us to see if you qualify to work with us. We have a growing list of clients that are ready and qualified to purchase a home”. Following this was a link to view properties in XYZ and XYZ and a link for realtors information. Included were pages for realtors to list their properties. These showed realty listings with pictures of properties that were “just sold”, “contract pending” and where “closing was completed in two weeks”. This “Properties” page solicited real estate sellers to list their properties here. No restrictions were given to those who wanted to advertise real estate properties for sale and no restrictions to neighborhood or geographical location of homes.

The ORG website claims that promoted links to public websites are being furnished for the convenience of the visitor, and that ORG has no business connections with any owners of the linked sites; the ORG Community partners links included a link to CO-6. A community Development Financial Institution located at Address City, State. ORG is located at the same street address.

**Counseling**

No education is offered by ORG. The counseling section of ORG website appears to be from HUD’s house counseling assistance programs. It describes HUD grants program and includes HUD statements such as HUD intends that these goals will make counseling an integral part of



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services for renters and homebuyers. ORG stated one of its goals was education through credit counseling and house counseling, however, the website shows no counseling or educational activities were provided by ORG for homebuyers. The counseling section of ORG website generally restated information developed by the Department of Housing and Urban Development (HUD); it describes who may provide counseling under HUD's grant program, how a counseling agency may apply for a grant from HUD, an extensive section with explanations of effective counseling and people skills for counselors, the counselor's role, the housing industry, and HUD developments. It explained that Fannie Mae has developed a number of materials that assist home ownership and reference to national organizations that provide housing counseling. However, there was neither a method to arrange for counseling from ORG nor was there any type of education module or material directed toward educating or counseling the homebuyer; therefore no counseling or education assistance was provided by ORG.

**APPLICABLE LAW:**

Adequate Records

IRC § 6001 provides that every person liable for any tax imposed by the IRC, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

IRC § 6033(a)(1) provides, except as provided in IRC § 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.

Treas. Reg. § 1.6001-1(a) in conjunction with Treas. Reg. § 1.6001-1(c) provides that every organization exempt from tax under IRC § 501(a) and subject to the tax imposed by IRC § 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 IRC § 6033.

Treas. Reg. § 1.6001-1(e) 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 as long as the contents thereof may be material in the administration of any internal revenue law.

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Treas. Reg § 1.6033-1(h)(2) provides that every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of subchapter F (section 501 and the following), chapter 1 of the Code and IRC § 6033.

Rev. Rul. 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization 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 provisions of IRC § 6033 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 exempt status.

In accordance with the above cited provisions of the Code and regulations under IRC §§ 6001 and 6033, 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.

Primary Activities

Treas. Reg. § 1.501(c)(3)-1(d)(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.” The Court found that the trade association had an “underlying commercial motive” that distinguished its educational program from that carried out by a university.

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.

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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.

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

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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., 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.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
<b>Name of Taxpayer</b> <b>ORG</b>		<b>Year/Period Ended</b> 20XX06

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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).

In Columbia Park and Recreation Association v. Commissioner, 88 T.C. 1 (1987), *aff'd* without published opinion, 838 F.2d 465 (4th Cir. 1988), the court held that an association formed in a private real estate development to operate parks, swimming pools, boat docks, and other recreational facilities did not qualify as a § 501(c)(3) organization. Although the organization provided some benefit to the general public, the primary intended beneficiaries were the residents and property owners of the private development. Thus, the organization operated for a substantial non-exempt purpose rather than for exclusively charitable purposes.

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

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

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
<b>Name of Taxpayer</b> <b>ORG</b>		<b>Year/Period Ended</b> 20XX06

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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.

Rev. Rul. 20XX-21, IRB: 20XX-21, discussed three situations of organizations providing down payment assistance and whether each qualified as charitable within the meaning of § 501(c)(3). Situation 1 described organization X whose purpose and activities relieve the poor distressed and underprivileged by enabling low-income individuals and families to obtain decent, safe and sanitary homes. The way organization X conducted its down payment assistance program established that the organization's primary purpose was to address the needs of its low-income grantees. See Rev. Rul. 70-585, Sit. 1. As a condition of providing assistance, X requires a home inspection to ensure that the house will be habitable. X's financial counseling seminars and other educational programs help to prepare potential home buyers for the responsibility of home ownership. See Rev. Rul. 67-138. X conducts a broad based fundraising program, and X receives support from a wide array of sources. X ensures that its grantmaking staff does not know the identity or contributor status of the party selling the home to the grant applicant (or any other party who may receive a financial benefit from the sale), and of not accepting contributions contingent on the sale of any particular properties, ensured that X was not beholden to any particular donors or other supporters whose interest may have conflicted with that of the low-income buyers X was working to help. X's grantmaking procedures combined with its efforts to educate home buyers ensured that X was operated primarily to benefit the low-income beneficiaries of its downpayment assistance. The low-income beneficiaries constitute a charitable class. Any benefit to other parties (such as home sellers, real estate agents, or

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer <b>ORG</b>		Year/Period Ended 20XX06

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developers) who participate in the transactions does not detract from the charitable purpose of relieving the poor and distressed. See Rev. Ruls. 72-559, 74-587, 76-419. The revenue ruling held that because X was operated exclusively for charitable purposes and qualified for exemption as an organization described in § 501(c)(3).

By contrast, Situation 2 described organization Y that was formed to finance its down payment assistance activities and relied on sellers and other real-estate related businesses that stood to benefit from the transactions Y facilitated. Furthermore, in deciding whether to provide assistance to a low-income applicant, Y's grantmaking staff knew the identity of the home seller and may have also known the identities of other interested parties and was able to take into account whether the home seller or another interested party was willing to make a payment to Y. Y's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and Y's reliance on these payments for most of its funding indicated 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. Like the organization considered in American Campaign Academy, Y was structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in American Campaign Academy, Easter House, and Columbia Park Recreation Association, Y also serves an exempt purpose, but because Y is not operated exclusively for exempt purposes, the revenue ruling held that the organization Y does not qualify for exemption from federal income tax as an organization described in § 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

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b> <b>ORG</b>		<b>Year/Period Ended</b> 20XX06

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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).

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.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 19XX-424 (19XX), aff'd, 19XX U.S. App. LEXIS 27982 (2d Cir. 19XX), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under § 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of KJ's Place, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of KJ's Place. The organization derived most of its funds from its lottery ticket sales. The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations. Although supporting charitable organizations may be a charitable activity, the Tax Court nevertheless upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of KJ's activities was to benefit KJ's place and its owners by attracting new patrons, by way of lottery ticket sales, to KJ's Place, and by discouraging existing customers from abandoning KJ's Place in favor of other lounges where such tickets were available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

**Effective date of revocation**



Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer <b>ORG</b>		Year/Period Ended 20XX06

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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 (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.).

**GOVERNMENTS POSITION**

ORG does not qualify as an organization described in I.R.C. § 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), (2) provides substantial private benefit to persons who do not belong to a charitable class. Additionally, ORG failed to meet the reporting requirements under Section 6001 and 6033 to be recognized as exempt from federal income tax.

Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of the regulations. ORG applied for exemption for the purpose of assisting addicted people. Yet its primary function is to operate a down payment assistance program. ORG'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 and Rev. Rul. 20XX-21, Situation 1. The down payment assistance program did not serve exclusively low-income persons. Despite ORG's representations that its DPA is designed for "low to moderate" income individuals, ORG does not have any income limitations for participation in its ORG program. ORG did not screen applicants for down payment assistance based on income. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. Based on multiple sales to real-estate professionals, the program is not even limited to first-time homebuyers.

ORG's program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4 and Rev.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer <b>ORG</b>		Year/Period Ended 20XX06

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Rul. 20XX-21, Situation 4. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes with no defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3) of the Code.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 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 ORG's program were directed to exclusively low-income individuals or disadvantaged communities, ORG's total reliance for financing its ORG 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), ORG is structured and operated to assist the private parties who fund it and give it business. The parties who benefited by the down payment program include realtors, builders and lenders; these parties benefited more than incidentally from ORG's operations as shown above under "Advertising and Real Estate Professional Activities". Sellers who participate in ORG's 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. They also benefit 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. Buyers who participate in ORG's program benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals who participate in ORG's program, from real estate brokers to escrow companies, benefit from increased sales volume and the attendant increase in their compensation. It is evident from the foregoing that ORG's program provides substantial private benefit to the various parties in each home sale.

The manner in which ORG operated its ORG program shows that the private benefit to the various participants in ORG's activities was the intended outcome of ORG's operations rather than a mere incident of such operations. See Rev. Rul. 20XX-21, Situation 2. 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 neither solicits nor receives funds from other sources. Before providing down payment assistance, ORG's grantmaking staff takes into account whether there is a home seller willing to make a payment to

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
<b>Name of Taxpayer</b> <b>ORG</b>		<b>Year/Period Ended</b> 20XX06

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cover the down payment assistance the applicant has requested. 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 an administrative fee of several hundred dollars per home sale. ORG secures an agreement from the seller stipulating to this arrangement prior to the closing. No ORG DPA assistance transactions take place unless ORG is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing. ORG's receipt of a payment from the home seller corresponding to the amount of the down payment assistance indicates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of ORG's operations. 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.

ORG's promotional material and its marketing activities show that ORG 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 ORG operated its ORG program shows that ORG was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect ORG'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., 20XX).

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 market its services primarily to persons within a charitable class. ORG's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. ORG 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 ORG's activities furthered commercial rather than exempt purposes.

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

The government proposes revoking ORG's exemption retroactively to January 1, 20XX because the organization operated in a manner materially different from that represented in its application for exemption. In its application for exemption signed under penalties of perjury June 27, 19XX,

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer <b>ORG</b>		Year/Period Ended 20XX06

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and on 1023 attachments, ORG represented that its purpose was to combat community deterioration in distressed urban areas and provide DPA to needy renters. The bulk of the home purchasers will be low-income individuals and families and efforts to sell at least 75% of the units to buyers with incomes below 80% of the area's median income, and to sell at least 50% to buyers with incomes below 50% of the median income. Downpayment assistance will be provided in the form of an "outright grant" and its activities were the acquisition, rehabilitation, and sale of residential properties in urban areas designated by government agencies for development grants. Activities included providing down payment assistance as well as advice and training in property maintenance to prevent future deterioration of the properties and communities. Despite these representations in its application for exemption, ORG does not have any income limitations for its DPA program and gave no indication that it screened for this to determine which applicants qualified. Rather, ORG's ORG program provided "gifts" to any homebuyers who qualified for a loan.

Furthermore, although ORG claimed on its application that home buyer educational was part of their program, it provided no education module for home buyers on its website and no education or counseling was provided by ORG instead, its website referred readers to HUD rules and other sources to obtain any type of education. Also, no information supported that ORG obtain verification from buyers that the buyers had reviewed or completed the education. See Rev. Rul. 20XX-21, Situation 1. Revocation of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 20XX-4, § 14.01. ORG's operation of its DPA activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of ORG's determination letter.

The website language appears to imply that the full amount of fees paid is tax deductible by prominently stating its exempt status, on its participating agreement completed by the seller.

In regards to ORG failure to respond to the Service's correspondence or file Form 990 for the tax period ending 20XX12, the Service considers the gross receipts of \$ shown on ORG's most recently filed return. Based on post operational receipts, a reasonable assumption is created to assume ORG met the requirement to file a return for the period under examination.

**TAXPAYER'S POSITION**

ORG's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. ORG will be allowed 30 days to review this report and respond with a rebuttal if considered necessary.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b> <b>ORG</b>		<b>Year/Period Ended</b> 20XX06

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**CONCLUSION:**

It is the IRS's position that the organization failed to meet the reporting requirements under IRC §§ 6001 and 6033 to be recognized as exempt from federal income tax under IRC § 501(c)(3). Accordingly, the organization's exempt status is revoked effective January 1, 20XX.

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. ORG's program is not operated in accordance with Internal Revenue Code § 501(c)(3) and the regulations thereunder governing qualification for tax exemption under Code. ORG provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. All "gifts" are seller funded.

In essence, these transactions result in a circular flow of the money. Because the amount of the "service fee" is always equal to the amount of the down payment assistance provided to the buyer plus a second service fee, in fact the actual source of the down payment assistance is the seller's service fee.

Evidence of ORG's collection of buyer income for "statistical purposes" coupled with ORG's definition of qualified applicants show that ORG did not consider the buyer's income when providing DPA. ORG offers its down payment assistance to interested buyers regardless of the buyers' income levels or need. ORG's activities do not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

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 is to maximize the fees from these transactions. ORG's brokering services are marketed to homebuyers, sellers, realtors, lenders, home builders, and title companies regardless of the buyers' income level or need and regardless of the condition of the community in which the home is located. Alliances are built with the realtors, lenders, home builders, and title companies to assure future business for the mutual benefit of the participants. ORG does not engage in any education, counseling, or other activities that further charitable purposes. Because ORG's primary activity is not conducted in a manner designed to further § 501(c)(3) purposes, ORG is not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that, in 20XX, ORG operated in a manner materially different from that represented in its Form 1023

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b> <b>ORG</b>		<b>Year/Period Ended</b> <b>20XX06</b>

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 company, CO-2 = 2<sup>nd</sup> company, CO-3 = 3<sup>rd</sup> company, CO-4 = 4<sup>th</sup> company, CO-5 = 5<sup>th</sup>  
 company, CO-6 = 6<sup>th</sup> company

application the government proposes that the revocation be effective retroactively to January 1, 20XX.

Form 1120 returns should be filed for the tax periods ending on or after January 1, 20XX.



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

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,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination  
Form 6018