



## DEPARTMENT OF THE TREASURY

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

### TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

August 12, 2008

Release Number: **200846025**

Release Date: 11/14/08

LEGEND

UIL: 501.03-01

ORG = Organization name

Address = address

XX = Date

ORG

Person to Contact:

ADDRESS

Identification Number

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN:

LAST DATE FOR FILING A PETITION

WITH THE TAX COURT: November 10, 20XX

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. Rather, you were operated for the benefit of private interests and a part of your net earnings inured to the benefit of outsiders, your founder and board members.

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

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending 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 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 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,

Vicki L. Hansen  
Acting, Director EO Examinations

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>20XX12</b>

LEGEND

ORG = Organization name      XX = Date      motto = motto      EMP-1 = 1<sup>st</sup> employee      President = president      CO-1 = 1<sup>st</sup> company      CO-2 = 2<sup>nd</sup> company

**ISSUE:**

Whether ORG (ORG) operates exclusively for an exempt purpose under Section 501(c)(3) of the Internal Revenue Code.

**BACKGROUND FACTS:**

ORG (ORG) is a not-for-profit corporation chartered on December 15, 20XX. The Articles of Incorporation were amended on March 29, 20XX.

ORG applied for recognition as a tax-exempt organization under Internal Revenue Code section 501 (c)(3) on Form 1023, Application for Recognition of Tax-Exempt Status. Its stated primary purpose was “review and dissemination of research done by other individuals . . . , grants to individuals to pursue research into methods of enhancing and prolonging life . . . , and research done by ORG staff into . . . .”

ORG was granted an advanced ruling as a public charity pursuant to section 509(a)(1) on April 24, 20XX. By letters dated December 1, 20XX, and May 3, 20XX, ORG was notified that it would be classified as a private foundation due to the non-receipt of Form 8734 (*Support Schedule for Advance Ruling Period*). This change was effective for years after 20XX.

For years prior to 20XX, a primary activity of ORG was promoting research which has as its objective enhancing and prolonging life, through grants for such research and publication of the results.

ORG reviewed and disseminated research done by other organizations with respect to methods and treatments that enhance lives. ORG made grants to individuals to pursue research into methods of enhancing and prolonging life. In 20XX, ORG disbursed over \$ for motto, including grants in the total amount of \$. Although the activities of ORG were limited due to limited resources in 20XX, it disbursed \$ to EMP-1 of the CO-1 for research into methods of prolonging life. ORG made no other disbursements in 20XX in furtherance of its exempt purpose.

In 20XX, ORG operated a Down Payment Assistance Program as described below. In that year, with the exception of the disbursement described above, the operation of the DPA program was ORG’s exclusive activity.

For 20XX and 20XX, ORG had no revenue from any source, including the operation of the Down Payment Assistance Program; the organization incurred expenses, however, in excess of \$ for professional fees, rent, bank charges, consulting fees, insurance, and advertising.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended <b>20XX12</b>

**Federal Returns**

ORG filed Forms 990 for the calendar years 20XX through 20XX; it filed Forms 990-PF as required for the calendar years 20XX and 20XX.

ORG reported on Form 990, contributions in 20XX in the amount of \$ and \$ in interest. The amount reported as contributions is receipts in the amount of \$ from the Down Payment Assistance Program (through CO-2), less disbursements; this amount was reduced by \$ for payments made for referral and marketing expense, resulting in the net receipt of \$ reported as the contributions on the return.

Part I of Form 990 for 20XX showed a decrease in net assets from the prior year. This decrease was due to payments for rent and other expenditures, including consulting expenses; the expenditures exceeded the receipts by \$.

Part III of Form 990 for 20XX indicated that the primary purpose of the organization was motto; President confirmed this purpose in an interview on August 30, 20XX.

**Operation of ORG’s Down Payment Assistance Program (DPA)**

Revenues received from the down payment assistance program were used to fund the motto purpose of the organization according to President. ORG, through its websites and flyers, advertising, and other methods, promoted its DPA program to builders, lenders, loan officers, mortgage brokers, real estate agents, title insurers, buyers, and sellers. Many of the participants in ORG’s DPA program utilized Federal Housing Administration (FHA) financing for their home purchase.

The website is no longer in use and has been blocked by its owner; however, promotional material provided by the other website, , (which has also now been shut down) explained the program as follows:

1. The program is called a “true gift” requiring no income limits.
2. For houses selling for less than \$, the seller pays ORG a service fee which consists of the grant (usually 3% of the sales price) plus the greater of \$ or 1% of the final sales price. For houses selling for more than \$, the fee is the amount of the Grant plus 1% of the final sale price.
3. The Grant Gift letter is sent to the Mortgage Company.
4. ORG then pays the total grant funds to the Title Company.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended <b>20XX12</b>

5. At the Closing, the Title Company withholds the service fee from the seller's proceeds.

6. These funds (service fee) were then transferred to ORG.

In essence, these transactions resulted in a circular flow of the money. The sellers made required payments to ORG of the amount equal to the amount the buyers would receive from ORG plus an additional transaction fee; ORG provided the funds to the buyers; the buyers used the funds to make the down payment to the sellers to purchase a home from the seller; the seller received the monies back as proceeds from the sale.

ORG's promotional material and advertising made it clear that anyone who could qualify for some type of loan would be eligible for the down payment assistance program.

Toll-free contact numbers were included on one of ORG's promotional hand-outs. One of the numbers was no longer in service; however, the number was still being used in November, 20XX, by the ORG president. In 20XX, the number is now answered, "Corporate office." President confirmed that the number is still in use by ORG but is not used for a DPA program.

**LAW:**

Section 501 of the Code provides for the exemption from federal income tax with respect to 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. IRC § 501(c)(3).

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United States, 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."

Treasury Regulation 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.

Treasury Regulation section 1.501(c)(3)-1(d)(2) defines the term "charitable" for section 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,

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended <b>20XX12</b>

to eliminate prejudice and discrimination, or to combat community deterioration. The term “charitable” also includes the advancement of education. Id.

Treasury Regulation section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term “educational” for section 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Treasury Regulation 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 section 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.

Revenue Ruling 2006-27 discusses whether organizations described in 3 situations operate exclusively for charitable purposes; the first two of these situations merit discussion here. The organization described in Situation 1 helps low-income families to purchase decent and safe homes in the metropolitan area in which it is located. Individuals are eligible to participate if they have the employment history and financial history to qualify for a mortgage with the exception that they do not have the funds necessary for down payments.

The organization in Situation 1 offers financial seminars, conducts educational activities to prepare the individuals for home ownership, and requires a home inspection report before providing funds for down payment assistance. To fund the program, the organization conducts broad based fundraising that attracts gifts, grants, and contributions from the general public. Further, the organization has policies in place to ensure that the grant making staff does not know the identity or contributor status of the home seller or other parties who may benefit from the sale and does not accept contributions contingent on the sale of particular properties.

Because the organization described in Situation 1 relieves the poor and distressed, requires a home inspection to insure that the house is habitable, conducts educational seminars, has a broad based funding program, and has policies to ensure that the organization is not beholden to particular donors, the Service held that the organization is operated exclusively for charitable purposes and qualifies for exemption from federal taxation as an organization described in section 501(c)(3).

The organization described in Situation 2 of Revenue Ruling 2006-27 is similar to the organization described in Situation 1 except that (1) its staff knows the identity of the party selling the home and may know the identity of other parties involved in the sale; (2) the organization receives a payment from the seller (the amount of which bears a direct correlation to the amount of down payment assistance provided) in substantially all the cases in which the organization provides assistance to the home buyers; and (3) most of its financial support comes from home sellers and related businesses that may benefit from the sale of homes to buyers who receive assistance from the organization.

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>20XX12</b>

Because the organization described in Situation 2 provides down payment assistance amounts that directly correlate to the amounts provided by home sellers and relies primarily on payments from home sellers and real-estate related businesses that stand to benefit from the transactions to finance its program, the Service held that the organization described in Situation 2 is not operated exclusively for exempt purposes and does not qualify for exemption from federal income tax as an organization described in section 501(3).

In Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988), 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 section 501(c)(3). The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency.

The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incidental 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 section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in section 501(c)(3) 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

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>20XX12</b>

may cause an organization to serve a private interest within the meaning of Treasury Regulation section 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 section 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 who were 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 section 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D. D.C. 2003), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

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

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).

Revenue Ruling 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. The organization described therein carried on several activities directed toward



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>20XX12</b>

the purpose of assisting low-income families to 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.

Revenue Ruling 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 section 501(c)(3).

Situation 3 described an organization set up 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 section 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 section 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 section 501(c)(3).

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>20XX12</b>

Benefiting Private Interests

An organization is not organized or operated exclusively for charitable purposes unless it serves a public rather than a private interest. 1.501(c)(3)-1(d)(1).

Revenue Ruling 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 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, Inc. v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 166 F.3d 1200 (2d Cir. 1998), 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 section 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 section 501(c)(3).

An organization does not serve a public rather than a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1) if any of its assets or earnings inure to the benefit of any insiders (or disqualified persons). Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Inurement is any transfer of charitable assets to the organization's insiders for which the organization does not receive adequate consideration. Inurement can take many forms. Excessive compensation

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>20XX12</b>

for services is a form of inurement. For example, in Mabee Petroleum Corp. v. United States, 203 F. 2d 872, 875 (5<sup>th</sup> Cir. 1953), the Fifth Circuit held that the organization's payment of a full-time salary for part-time work constituted private inurement.

The use by insiders of the organization's property for which the organization does not receive adequate consideration is a form of inurement. See, e.g., The Founding Church of Scientology v. United States, 412 F.2d 1197, 1201 (Ct. Cl. 1969) (holding that the insiders' use of organization-owned automobiles and housing constituted inurement); Spokane Motorcycle Club v. United States, 222 F.Supp. 151 (E.D. Wash. 1963) (holding that the organization's provision of goods, services and refreshments to its members constituted inurement).

Loans that are financially advantageous to insiders from the organization's funds (particularly unexplained, undocumented loans) are a form of inurement. For example, in The Founding Church of Scientology, 412 F.2d at 1200-1201, the Claims Court listed unexplained loans to and from insiders among the examples of inurement. In Church of Scientology v. Commissioner, 823 F.2d 1310, 1314-15, 1318 (9<sup>th</sup> Cir., 1987), the Ninth Circuit held that "debt repayments" in the form of 10 percent of the organization's income made to the organization's founder, allegedly to compensate the founder for the organization's past use of his personal income and capital, constituted inurement. In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D. D.C., 2003), the court held that forgiveness of interest was a form of inurement.

Leasing arrangements that favor disqualified persons to the detriment of the organization are a form of inurement. In The Founding Church of Scientology, 412 F.2d at 1201-02, the Claims Court treated the organization's payment of rent to the founder's wife as inurement in the absence of any showing that the rental was reasonable or that the arrangement was beneficial to the organization. See also Texas Trade School v. Commissioner, 272 F.2d 168 (5<sup>th</sup> Cir. 1959) (holding that inflated rental prices constitute inurement).

Payment to one person for services performed by another (or for services presumed to be performed, without any proof of performance) is also a form of inurement. In Church of Scientology, 823 F.2d at 1314, 1317-18, the court listed royalties received by the organization's founder on the sale of publications written by others among the improper benefits received by the founder from the organization. In The Founding Church of Scientology, 412 F.2d at 1202, the court held that the payment of salary to the founder's daughter without any proof that she actually performed any services for the organization constituted inurement.

A number of courts have held that unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control can constitute inurement. See Parker v. Commissioner, 365 F.2d 792, 799 (8<sup>th</sup> Cir. 1966); Kenner v. Commissioner, 318 F.2d 632 (7<sup>th</sup> Cir. 1963); and Church of Scientology, 823 F.2d at 1316-17, 1319.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended <b>20XX12</b>

The provision of inurement can be direct or indirect. In Church of Scientology, 823 F.2d at 1315, the organization transferred in excess of \$3.5 million to a for-profit corporation incorporated by the organization's founder and his wife. The directors of the corporation were high-ranking members of the Church of Scientology. The directors approved the founder's decision to transfer \$2 million from the corporation's account to the ship *Apollo* aboard which the founder and his family lived. The Ninth Circuit held that the funds funneled through the for-profit corporation constituted inurement to the founder and his family. Church of Scientology, 823 F.2d at 1318.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9<sup>th</sup> Cir. 1985), the Ninth Circuit held that a church that conducted its activities by mail did not qualify for exemption under section 501(c)(3) because a substantial purpose of its activities was to benefit a for-profit corporation controlled by the church's insiders. The church employed an advertising agency controlled by its insiders to provide all of the printing and mailing services for the church's mass mailings. The advertising agency devoted approximately two-thirds of its time to the work for the church. The majority of the church's income was paid to the advertising agency. Although the advertising agency claimed to have clients unrelated to the church, it did not advertise its services and refused to identify its other clients.

The Ninth Circuit held that the church was operated for the substantial non-exempt purpose of "providing market for [the advertising agency's] services" and, thus, primarily served the private interests of the advertising agency and its owners rather than a public purpose. Id. at 1391. In so holding, the Ninth Circuit rejected the church's argument that the income paid by the advertising agency should not be included in the determination of reasonableness and treated this income as indirect inurement of the church's earnings to the church's insiders.

#### Effective date of revocation

Generally, an organization may rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, 2003-1 C.B. 123, §14.01 (cross-referencing §13.01 et seq.). 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, 1990-1 C.B. 514, §13.02.

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

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>20XX12</b>

## ANALYSIS

Section 501(c)(3) of the Internal Revenue Code (IRC) 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.

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in IRC section 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. United States, 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.”

Treasury Regulation 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.

ORG operated a Down Payment Assistance program that did not further an exempt purpose. Like the activities of the organization in American Campaign Academy, 92 T.C. 1053 (1989), ORG’s Down Payment Assistance program was structured to assist the private parties who funded it. Sellers of homes benefited by being able to sell their homes at the full listed prices; buyers benefited by being able to buy homes without commitment of their own funds as down payments; and real estate professionals benefited from the higher commissions paid associated with the full listed prices. No charitable class benefited since the prospective buyers were not limited to low-income. No particular community in need of rehabilitation was targeted.

Although ORG engaged in some exempt activities before 20XX by giving grants in furtherance of its exempt purpose, in 20XX ORG engaged almost exclusively in a nonexempt activity by operating the Down Payment Assistance program. ORG did not disclose or describe the DPA activity on its application for exemption. Moreover, ORG did not adequately disclose the change in its operations on its Forms 990. The DPA program was a new activity for ORG, which is materially different from the activities in which ORG represented it would engage and that formed the basis of the Internal Revenue Service’s recognition of the organization as an exempt entity.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. ORG’s down payment assistance program was designed to channel funds in a circular

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>20XX12</b>

manner from the sellers to the buyers and back to the sellers in the form of increased home prices.

ORG's DPA program had not been operated exclusively for an exempt purpose. ORG operated its DPA program in a manner similar to the operation by the organization described in Revenue Ruling 2006-27, Situation 2. In 20XX, the DPA program was more than an insubstantial part of the organization's activities. During the years that ORG provided down payment assistance, purportedly in the form of gifts, to individuals and families for the purchases of homes, ORG offered its down payment assistance to interested buyers regardless of the buyers' income levels or needs. ORG's DPA activities did not target neighborhoods in need of rehabilitation or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

ORG's down payment funding activity involved brokering transactions to facilitate the selling of homes in the manner indistinguishable from a for profit entity in the business of brokering real estate transactions. An exempt organization's primary purpose may not be the operation of an unrelated trade or business. See Treas. Reg. § 1.501(c)(3)-1(e). ORG's brokering services were 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 were built with the realtors, lenders, home builders, and title companies to assure future business for the mutual benefit of the participants.

**Organization's Position:**

ORG reports that it ended the Down Payment Assistance program in 20XX and plans to rely on public and private research grants and donations as the means of funding its primary purpose of motto in the future. It does not agree that revocation of its exempt status is appropriate.

**Conclusion:**

Since the DPA activities of ORG were more than insubstantial, it was not operated exclusively for an exempt purpose. Therefore, its status as an exempt organization described in section 501(c)(3) should be revoked effective January 1, 20XX.



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service  
TE/GE EO Examination  
1100 Commerce St. Mail Code 4957:DAL  
Dallas, TX 75242-1027

April 22, 2008

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.

Letter 3618 (04-2002)  
Catalog Number 34809F

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

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

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination