



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examination

625 Fulton Street, Room 503

Brooklyn, NY 11201

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: August 8, 2008

Release Number: 200846029

Release Date: 11/14/08

LEGEND

ORG = Organization name

Address = address

UIL:501.03-01

XX = Date

ORG
ADDRESS

Taxpayer Identification Number:
Person to Contact:
Identification Number
Contact Telephone Number:

LAST DATE FOR FILING A PLEADING WITH
THE TAX COURT, THE CLAIMS COURT, OR
THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA:
November 6, 20XX

Dear :

This is a final determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Recognition of your exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3) is retroactively revoked to January 1, 20XX because it is determined that you are not operated exclusively for an exempt purpose.

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

We have determined that you are not operating exclusively for any charitable purpose, educational purpose, or any other exempt purpose. Our examination reveals that you are not conducting charitable activities, educational activities, or any other exempt activities pursuant to IRC section 501(c)(3). Your activities, including your financial transactions, more than insubstantially furthered non-exempt purposes. Moreover, you failed to establish that you were not operated for the benefit of private interests of your officer and other private individuals as required for continued recognition of exemption pursuant to Treas. Regs. 1.501(c)(3)-1(d)(1)(ii).

We are revoking your exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code effective January 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 returns on Form 1120. These returns should be filed with the appropriate Service Center for all years beginning January 1, 20XX.

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

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

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

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

Enclosure:
Publication 892

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX 12/31/20XX 12/31/20XX

LEGEND

ORG = Organization name XX = Date XYZ = State Address = address
 Bank = bank President = president Vice President = vice president
 President's son = presidents son

Issue:

Whether ORG operated exclusively for exempt purposes within meaning of section 501(c)(3)?

Facts:

ORG (ORG) is a XYZ not-for-profit corporation incorporated on April 2, 19XX. The name of the organization on its Form 1023, application for recognition as a 501(c)(3) organization, was "ORG" The organization amended its Articles of Incorporation on March 23, 20XX to change its name to ORG. The records of the office of XYZ Secretary of State reflect that ORG is the organization's assumed name. President is ORG's registered agent and founder. He is listed on the 20XX form 990 as the President. ORG's address is Address City, XYZ

On August 17, 19XX, ORG applied for recognition as a tax-exempt organization under section 501(c)(3). On December 13, 19XX, based on the information that ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, ORG was recognized, as of April 2, 19XX, as a tax-exempt organization as described in section 501(c)(3).

Since 19XX ORG has promoted and operated a Down Payment Assistance (DPA) program in which it provides funds to home buyers to use as their down payments and collects the same amounts, plus additional fees, from the home sellers. As more fully described below, under ORG's 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.

Application for Recognition of Tax-Exempt Status:

Form 1023 was filed by ORG with the IRS to apply for recognition of tax-exempt status under penalties of perjury on August 17, 19XX. On its Form 1023, ORG detailed the following activities:

ORG desires to provide the community with a resource to upgrade and enhance the quality of living in our neighborhoods and communities.

This objective will be achieved by providing home ownership both existing and new homes. We will also provide for our communities the rehabilitation of existing homes that are in need of repairs.

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Our immediate focus will be to provide housing to the low to moderate income persons through the HUD resale program. This will be 50% of our focus. The other 50% of our time will be spent with the restoration and rehabbing of existing neighborhoods.

In the year 20XX we will begin building new homes for the low to moderate income home owner.

By letter dated November 2, 19XX, the Internal Revenue Service asked ORG to provide additional information in order to make a determination on the filed Form 1023. The requested information and responses were as follows:

1. Please provide the attachment for page 8, line 17.
“The director, President, will be the only salaried person. None of the officers or trustees will be salaried.”
2. What percentage of your housing will be made available for moderate income individuals?
“Approximately thirty (30%) percent.”
3. What percentage of your housing will be for low income individuals?
“Approximately seventy (70%) percent.”
4. What is the median income level?
“The median income level is \$.”
5. What income level of people will you be working with?
“I will be working with persons with no income (such as homeless persons), to those persons with a household income of \$ per year.”

Regarding the organization’s sources of financial support, ORG’s application for exemption listed the following sources:

“HUD set aside, city grants, community grants, HUD grants, etc.”

Regarding fundraising, the application states the following:

“For now, we plan to deal only with housing programs already in existence for our funds.”

Nowhere on its original application does ORG indicate that it will provide a DPA program. However, from its inception, it has been involved primarily in a DPA program. In 20XX and 20XX, 100 percent of ORG’s income came from through its DPA program. In 20XX, ORG began to purchase HUD properties at a discount that were to be resold to low to moderate income home buyers. ORG made repairs to the homes and started reselling them in 20XX. Due to poor

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recordkeeping, the exact amount of income for 20XX attributable to its DPA program could not be determined and was estimated by President to be 75 percent of its activity. ORG was audited by HUD in 20XX; its approval Certification allowing them to buy HUD homes at a discount and resell them was rescinded. Per President, ORG began to sell the homes to anyone, regardless of income; this practice was prohibited under the HUD Resell Program guidelines.

Articles of Incorporation:

The Articles of Incorporation for ORG, dated March 31, 19XX, state the following:

A. The Corporation is organized exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 19XX, as amended (the "Code"), including for such purposes the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Code (or the corresponding provision of any future United States Internal Revenue Law)."

Restrictions on Powers.

B. This Corporation is not organized and shall not be operated for pecuniary gain or profit. No part of the property or net earnings of the Corporation shall inure to the benefit of or be distributable to its directors, officers or other private persons, except that the Corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article VI hereof."

ORG has a dissolution clause which requires that upon dissolution remaining net assets will go to another section 501(c)(3) organization.

Federal Returns:

ORG filed Forms 990 for the calendar years ended December 31, 20XX, 20XX, and 20XX; it did not file Forms 990-T. ORG did not file Forms 941, W-2, and 1099-MISC.

In 20XX and 20XX, ORG's only reported activity consisted of operating its DPA program as described in more detail below.

Part III of ORG's 20XX Form 990 states, "The organization provides homeownership counseling and down payment assistance to low income families and first time homeowners."

In 20XX, 20XX, and 20XX, ORG received the respective amounts of \$; \$ and \$, in gross revenue from amounts paid to it by sellers participating in ORG's DPA program. ORG reported the seller's payments as contributions. ORG also reported that it distributed the respective amounts of \$; \$; and \$, in down payment assistance to homebuyers for use as down payments and/or to pay for closing costs in 20XX, 20XX, and 20XX. ORG's Form 990, Part IV,

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line 73, shows that, as of December 31, 20XX, ORG had total unrestricted/net assets valued at \$

Operation of ORG's Down Payment Assistance Program:

ORG, through its website, flyers, advertising, and other methods, promotes its DPA program to builders, lenders, loan officers, mortgage brokers, real estate agents, buyers, and sellers. Many of the participants in ORG's DPA 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 receive gifts to use for the down payment only from a relative, employer, labor union, charitable organization, close friend, governmental agency, or public entity. The rules do not permit the seller to lend money to the buyer for the down payment.

Once the buyer locates a home he/she wants to purchase, the buyer and seller enter into a contract. Each seller must sign a Participating Home Agreement as a part of the contract. This agreement obligates the seller, in consideration for participating in ORG's DPA program, to pay ORG an amount equal to the amount of the down payment assistance received by the buyer, plus a service fee (1% or a flat fee). The agreement, required to be signed by each participating seller, includes the following statement:

The Seller agrees to pay ORG Down Payment Assistance Program a Service Fee of ___% based on the Final Sales Price of the Participating Home at the close of escrow (this includes the grant amount plus 1%). This form will serve as demand upon closing. THE SELLER IS NOT OBLIGATED AND DOES NOT PAY A SERVICE FEE if the Participating Home is purchased by a Buyer not utilizing ORG Down Payment Assistance Program's Grant/Gift or should the Participating Home not close.

The seller compensates for the amount he/she is providing as Down Payment Assistance and the fee by increasing the sales price of the home. ORG provides a form to be used by Real Estate Agents/Brokers entitled "How to Find the True Contract Price When using Down Payment Assistance." This form includes an equation for computing the amount of the sales price of the home to include the DPA and service fee.

ORG does not provide down payment assistance to the buyer if the seller does not enter into the agreement. If the seller agrees to participate, the agent and buyer proceed to try to get the buyer approved for a loan through a mortgage company which will accept gift funds from a section 501(c)(3) organization. ORG provides the lender with a Gift Fund Acknowledgement letter to advise the lender of the amount of the "gift funds" the buyer will receive. When the loan is approved, the organization is notified and the closing attorney sends to ORG wiring instructions.

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ORG will wire or deliver the “gift funds” to the closing attorney (the money is never given to the buyer). The check is made out to the closing attorney, buyer, or, in some instances, both. At closing, ORG faxes a copy of its closing instructions to the closing attorney. Once the closing is completed, the closing attorney gives a check to ORG for the down payment assistance plus the fee. ORG’s President, President, sometimes attends the closing to personally receive the check at closing; if he does not attend, the closing attorney will mail a check to ORG.

If the sale is not completed, the seller provides no funds to ORG. In 20XX and 20XX ORG received 100% of its income from transactions where there is an agreement between a buyer and seller regarding a specific property owned by the seller. ORG does not provide “gift funds” to any buyer when the seller of the home does not agree to participate in the agreement.

ORG does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The records provided by ORG did not include data on the buyers’ incomes and gave no indication that ORG screened on such data. Rather, ORG’s DPA program provided “gifts” to any homebuyers who qualified for a loan.

On the HUD Settlement Statement for each closing, the “gift funds” plus the service fee charged by ORG is shown as “Gift Funds/Service Fee” on the seller’s summary of transactions; on the buyer’s summary, the DPA less ORG’s fee is shown as “ORG Gift Funds”.

In essence, these transactions result in a circular flow of the money. The sellers make payments to ORG. ORG provides the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller’s home.

ORG also falsely labeled the seller’s payment to ORG as a “gift” on its Gift Fund Acknowledgement (Form DSR102) which was provided to each Mortgage Co./Broker. The form certifies the following to the Mortgage Co./Broker:

1. ORG is an approved IRC 501(c)(3) organization.
2. ORG will provide “gift funds” to the buyer,
3. Amount of the “gift funds”,
4. The buyer does not have to re-pay the “gift funds” and
5. The buyer is not related to any ORG Officers, Board members or employees.

In addition, upon request, ORG indicated that it provided counseling to homebuyers. President estimates that ORG provided counseling to approximately 50 persons in 20XX. ORG has no contemporaneous records for the counseling; President estimates that approximately 5% of the number of buyers who received gift funds request counseling.

Financial Information:

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President maintains the checkbook for ORG. The organization had 1 main checking account with Bank through which 99% of the activity of the organization was conducted. A second checking account with bank had little activity. There were no deposits made into the Bank account in 20XX or 20XX. Both President and Vice President (Vice President) have signature authority for signing checks. President signed approximately 95% of the checks in 20XX. President did not have an accountant in 20XX, 20XX, or 20XX; the books and records were kept by President and his part time employees, one of whom is his son, President's son. President paid personal expenses from the organization's bank account with Bank. In conversations with President, he stated that he did not know that he was doing anything wrong and considered the amounts paid for personal expenses to be his compensation.

In 20XX and 20XX, ORG's only sources of revenue were from service fees from its DPA program. The total revenue is the gross amount of the seller service fee. On the expense side, ORG pays out the gift funds/grants to the buyers. The difference is kept by ORG as its fee. For 20XX, ORG sold homes that it purchased under the HUD Resale Program. The proceeds from the home sales and the gross amount of the seller service fees from its DPA program were the only sources of income for 20XX; ORG makes no solicitations for charitable contributions.

Regarding compensation, ORG did not pay President an amount designated as a salary. President paid personal and household expenses from ORG's checking account purportedly in lieu of paying himself a salary/compensation. The original application lists President as the President and indicates he is to receive compensation. President has performed the duties of the EO President and has considered himself the President of ORG from its inception. President is not listed as the president on the 20XX or 20XX Form 990, Part V. The persons listed in Part V of Form 990 as Officers, Directors, Trustees, and Key Employees performed no duties for ORG and received no compensation. Form 990, Part V, for 20XX lists President as the President of ORG.

For 20XX, 20XX, and 20XX, ORG paid personal expenses for President in the respective amounts of \$; \$; and \$. ORG did not report any amounts as compensation paid for officers in Part V of its Forms 990 for those years. It issued no Forms W-2 for either year. President filed Form 1040 and reported income from ORG in the amounts of \$ in 20XX (Schedule C, non-employee compensation), \$ in 20XX and \$ in 20XX.

Wages

ORG's Forms 990 show "Other salaries and wages" for 20XX and 20XX in the amounts of \$ and \$, respectively. Its Form 990 for 20XX shows the total amount of \$ for salaries/wages as "Other Expenses" on line 43b. After review of its books and records, ORG verified wages paid to its 2 part-time employees in the amounts of \$ in 20XX, \$ in 20XX and \$ in 20XX. ORG did not issue Forms W-2 to its employees.

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Internal Control

ORG has no internal controls. President, Founder/President (20XX), controls all bank accounts; he and his wife, Vice President, are the only signatories on the checks. Vice President is listed as the Vice President on the 20XX Form 990, Part V. For 20XX and 20XX the Officers/Directors listed on Forms 990 appear to be Officers/Directors in name only. President stated that there is an annual board meeting held each year; no minutes, however, are kept with respect to these meetings. The officers listed on the 20XX and 20XX returns make no decisions, perform no duties, and have no input in the day-to-day operations of ORG.

Law & Argument

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings of such corporations inures to the benefit of any private shareholder or individual. See I.R.C. § 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, to eliminate prejudice and discrimination, or to combat community deterioration. The term “charitable” also includes the advancement of education.

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

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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. United States, 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988) (unpublished table decision), the 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 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 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 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.

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In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of 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 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. In Revenue Ruling 67-138, the organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) conducting a training course on various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

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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 section 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 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 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) and the regulations.

Revenue Ruling. 2006-27, 2006-21 C.B. 915, in part, discusses whether down payment assistance organizations described in 3 situations operate exclusively for charitable purposes. Those described in Situations 1 and 2 are relevant to this discussion. The organization described in Situation 1 makes assistance available to low-income families to purchase decent and safe

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homes throughout the metropolitan area in which it is located. Individuals are eligible to participate if they are low-income and 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 grantmaking 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 ensure 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 like that 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.

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 the 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(c)(3).

Benefiting Private Interests:

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

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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 section 501(c)(3) because it gave preference to employees of a 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 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).

Effective date of revocation:

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, 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.

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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.).

Analysis:

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

Charitable purposes include relief of the poor and distressed. See Treas. Reg. § 1.501(c)(3)-1(d)(2). 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. The down payment assistance program did not serve exclusively low-income persons. ORG does not have income limitations for participation in its DPA program and did not screen applicants for down payment assistance based on income. ORG's records do not include data on the buyers' incomes. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. The program is not limited to first-time homebuyers.

ORG's DPA 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. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes in a broadly 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 DPA program were directed to exclusively low-income individuals or disadvantaged communities, ORG's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program 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. Sellers who participate in ORG's DPA program benefit from achieving access to a

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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 homes at the full listed prices or by being able to reduce the amounts of the negotiated discounts on their homes. Buyers who participate in ORG's DPA program benefit by being able to purchase a home without having to commit their own funds for down payments. Real estate professionals who participate in ORG's DPA 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 DPA program provides ample private benefit to the various parties in each home sale.

The manner in which ORG operated its DPA 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. 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.

Like the organization described in Situation 2 of Revenue Ruling 2006-27, ORG neither solicits nor receives funds from other sources. Before providing down payment assistance, ORG's staff takes into account whether there is a home seller willing to make a payment to 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 DPA assistance transaction takes 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 instructions to title and escrow companies provide that at the close of escrow the seller's contribution, along with any ORG fees, must be sent to ORG within 72 hours. ORG's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction and ORG's reliance on these payments for most of its funding indicate that the benefit to the home seller is a critical aspect of Y's operations. In this case, given the fact that the economic incidence of the seller's contribution to the Corporation fell on the buyer rather than the seller, the benefit to the sellers is even greater. The sellers got the benefit of having their property sold quicker (due to greater number of potential home buyers) without actually incurring any costs. Because the amount that home buyers received from ORG was incorporated into the sale price of a home, the purported beneficiaries in fact did not receive anything from ORG. Further, because the transaction fees charged by ORG could be based on a percentage of the home's sale price, ORG benefited from the transactions by maximizing its fees. The circular cash flow indicates that the Corporation's primary goal was to facilitate transactions for the benefit of private parties involved or connected to these transactions, i.e., buyers (who were not necessarily

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members of a charitable class), sellers, real estate professionals, etc. In this respect, ORG is like the organization considered in Easter House which provided health care to indigent pregnant women 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 section 501(c)(3). The manner in which ORG operated its DPA 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. 2003).

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), 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, 92 T.C. 1053 and Easter House, 12 Cl. Ct. 476, a substantial part of ORG's activities furthered commercial rather than exempt purposes. Like the organization described in Situation 2 of Revenue Ruling 2006-27, the circular flow of funds indicates that the primary goal of ORG was to benefit private parties involved in the transaction and to maximize fees paid to ORG rather than to accomplish an exempt purpose.

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

The government proposes revoking ORG's exemption, effective the date of the organization's inception because the organization operated in a manner materially different from that represented in its application for exemption. In its application for exemption signed under penalties of perjury on August 17, 19XX, ORG represented that its purpose was to "provide housing to the low to moderate income persons through the HUD resale program. This will be 50% of our focus. The other 50% of our time will be spent with the restoration and rehabbing of existing neighborhoods. In the year 20XX we will begin building new homes for the low to moderate income home owner."

In response to additional information requested concerning its application for exemption, ORG

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represented that 30% of the housing would be made available for moderate income individuals, 70% of its housing would be for low income individuals; the median income level of home buyers would be \$. and ORG would be working with persons with incomes ranging from none (homeless persons) to \$. per year. Nowhere on its application for exemption did ORG indicate that it would provide down payment assistance. From day one, however, ORG's primary activity has been down payment assistance. ORG does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income.

The records provided by ORG did not include data on the buyers' incomes and gave no indication that ORG screened applicants with respect to such data. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. Further, although ORG indicated that it provided counseling to home buyers, no contemporaneous records were kept to verify the number of persons counseled or the type of counseling provided. 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); Rev. Proc. 2003-4, § 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.

Conclusion:

In order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated to achieve a purpose that is described under that Code section. ORG's DPA program is not operated in accordance with section 501(c)(3) and the regulations thereunder governing qualification for tax exemption under the Code. ORG provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. ORG offers its down payment assistance to interested buyers regardless of the buyers' income levels or need. ORG's DPA activities do not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

ORG operates a trade or business in a commercial manner designed to maximize profits rather than serve charitable purposes. Its activities further the private interests of home sellers and other real estate related businesses. 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, and home builders to assure future business for the mutual benefit of the participants. Because ORG's primary activity is not conducted in a manner designed to further section 501(c)(3) purposes, ORG is not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

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For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that, in 20XX, 20XX and 20XX, ORG operated in a manner materially different from that represented in its Form 1023 application the government proposes that the revocation be effective retroactively to the date of the organization's inception.

Taxpayer's Position:

ORG's President, President, has received and reviewed this report and is in agreement with the facts, law and conclusion as presented. President has signed Form 6018 indicating his consent to the proposed revocation of ORG's exempt status as a 501(c)(3) organization.



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE, Exempt Organizations
401 W. Peachtree St., Stop 504-D
Atlanta, GA 30308

January 22, 2007

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, Exempt Organizations

Enclosures:
Publication 892
Publication 3498
Report of Examination