Internal Revenue Service
Appeals Office
1352 Marrows Road, Suite 104
Newark, DE 19711-5445

Number: **200901034**
Release Date: 1/2/2009

Date: September 30, 2008

A

B

Department of the Treasury

Person to Contact:

Employee ID Number:
Tel:
Fax:
Refer Reply to:
AP:FE:
In Re:
EO Revocation
Tax Period(s) Ended:

Form Number
1120
Employer Identification Number
C

UIL Code: 501.03-05
501.33-00

CERTIFIED MAIL

Last Day to File a Petition with the
United States Tax Court:

Dear

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code. It is determined that you are no longer recognized as exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code, effective . Your application for exemption (Form 1023) and associated materials misstated material fact, and you operated in a manner materially different than originally represented.

Our adverse determination was made for the following reason(s):

> 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).

Contributions to your organization are not deductible under code section 170.

You are required to file Federal income tax returns on the form indicated above.

If you decide to contest this determination under the declaratory judgment provisions of code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed before the 91st (ninety-first) day after the date this determination was mailed to you. Contact the clerk of the

appropriate court for rules for filing petitions for declaratory judgment. To secure a petition from the United States Tax Court, write to United States Tax Court, 400 Second Street, NW, Washington, D.C. 20217.

The last day for filing a petition for declaratory judgment is __ _____.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

You also 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 is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. 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. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

Thank you for your cooperation.

Sincerely,

for CHARLES FISHER
TEAM MANAGER

Enclosures:
Notice 1214 Helpful Contacts for your 'Deficiency Notice'

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
230 S Dearborn, 17th Floor MC4929CHI
Chicago, IL 60604.

April 6, 2007

A
B

Taxpayer Identification Number:
C
Form:
990
Tax Year(s) Ended:
and
Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service **Explanation of Items**	Schedule No. or Exhibit
Name of Taxpayer XXXXX		Year/Period Ended

ISSUE

Whether XXXXX operated exclusively for exempt purposes within the meaning of Internal Revenue Code (I.R.C.) § 501(c)(3)?

FACTS

XXXXX is a XXXXX not-for-profit corporation incorporated on January 31, . XXXXX is XXXXX's registered agent and president. XXXXX's address is XXXXX, XXXXX, XXXXX .

On January 02, XXXXX applied for recognition as a tax-exempt organization under I.R.C. § 501(c)(3) on Form 1023 (Application for Exemption or Application). On April 16, , based on the information that XXXXX provided in its Application for Exemption and on the assumption that the Organization would operate in the manner represented in its Application, XXXXX was recognized, as of January 31, , as a tax-exempt organization as described in § 501(c)(3).

Since XXXXX has promoted and operated a down payment assistance (DPA) program for house buyers under which it provides funds to the buyers to use as their down payment or for closing costs and collects the same amount, plus an additional fee, from the house sellers. As more fully described below, under XXXXX'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

On January 02, under penalties of perjury, XXXXX filed Form 1023 with the IRS to apply for recognition of tax-exempt status under I.R.C. § 501(c)(3). In its Application XXXXX stated that its purpose was to assist low and middle income home buyers in obtaining mortgage financing for purchase of a home. The Application stated that the Organization planned to provide down payment assistance for low income individuals and families to allow individuals who could not otherwise do so to own their own home. According to the Application, XXXXX would help prospective home buyers by making cash grants to be applied towards such expenses as down payment and funding tax escrow, loan fees, inspections, credit checks or appraisals.

Income limits and financial need

The Application stated that "down payment assistance will be provided only to individuals who have a financial need for such services, and who complete the educational requirements designed to increase the likelihood of permanent home ownership". One of the materials distributed to prospective clients specifically stated that income limits are not considered in making a determination of the grant.

Source of Income

In regard to fundraising and contributions, XXXXX's Application for exemption stated that the Organization expected financial support from gifts from individuals, grants and loans from initial directors, grants and contributions from the community at large, and contributions from participants in XXXXX programs. However, the review of XXXXX's books and records during the examination disclosed that 99.99% of the Organization's gross revenue was received from sellers who participated in the XXXXX Programs.

Federal Returns

XXXXX did not file Forms 990 from its inception in through . A "Request for Information about Tax Return" that was sent to the Organization by the IRS processing center for the period ended December 31, was returned by XXXXX with Section II, Box1 of the form checked. According to the completed form that it returned, XXXXX was not required to file because its annual gross receipts were normally $25,000 or less. The Organization filed Form 990-EZ for the period ended December 31, , reporting gross receipts of $.

In and , XXXXX only reported activity consisted of operating its DPA program. The review of the books and records provided for the period disclosed that XXXXX assisted low-to median-income homebuyers. According to Part III of XXXXX's Forms 990-EZ, "XXXXX helped low to median household income homebuyers, buy homes and strive to help others through education and decimination [sic] of information in their goal of owning a home".

In and XXXXX received $ and $, respectively, in gross revenue from amounts paid to it by sellers participating in the Organization's DPA program. XXXXX reported the payments as "contributions" on its Forms 990-EZ for those years. The Organization reported that it distributed and $ in and , respectively, in down payment assistance. XXXXX's Form 990, Part II, line 27 reports that as of December 31, the Organization's net assets or fund balance was $.

XXXXX, through its website (www.XXXXX.org), flyers, advertising, and other methods, promotes its DPA program to builders, lenders, loan officers, mortgage brokers, real estate agents, title insurers, buyers, and sellers. Many of the participants in taxpayer'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 only receive gifts to use for the down payment from a relative, employer, labor union, charitable organization, close friend, governmental agency, or public entity. The seller cannot loan money to the buyer for the down payment.

According to XXXXX's website and its other publications, XXXXX's down payment assistance program works as follows:.

- Once a buyer has begun to look for a house, the real estate agent informs the client about XXXXX's DPA program. The buyer completes "The XXXXX Grant Application." The buyer agrees to make a cash investment of at least one percent (1%) toward the purchase of a participating home or demonstrate ability to make such an investment. The buyer must successfully complete homebuyer course if required by the lender.

- After the buyer has found a house to purchase and begins negotiations with the seller, the seller is informed about the program and its benefits. The seller completes "The XXXXX's Program Seller Participating Agreement" (Seller Agreement) and agrees to make a contribution to XXXXX that is between 3% - 5%, plus an additional fee of between 0.75% - 1% of the contract sales price within three (3) business days from the transfer of the participating Home to the buyer. The additional fee represents an "administrative fee" charged by XXXXX for facilitating the DPA program in terms of services provided to homeseller and homebuyer.

- The lender determines the amount of gift funds the buyer will require from the XXXXX program in order to complete the purchase transaction. The lender submits the completed Original Grant Application to the Closing office. The lender is also responsible for noting on the grant application the source of the buyer's 1% funds toward the purchase of the home.

- Escrow is instructed to withdraw proceeds in the amount of the down payment from the seller's closing statement and to categorize the amount as a contribution to xxxxx. The "contribution" amount, excluding xxxxx's Fee," is added to the buyer's closing escrow statement as a gift from xxxxx and is used as the buyer's down payment.

- According to xxxxx's website, its program simplifies the down payment assistance process by requiring less documentation and inspections than other similar entities. The website also indicates that the xxxxx Program encourages the buyer to look into purchasing a home warranty that typically covers major home mechanical systems, including the plumbing, electrical and heating systems.

Through taxpayer's DPA program, buyers receive a "gift" of the funds that they use for the down payment. During the years under examination, the down payment "gifts" were generally between 3% and 5% of the property's stated sales price. A house buyer was eligible to participate in taxpayer's DPA program only if the buyer purchased a house from a seller that agreed to taxpayers' contractual terms. Taxpayer and sellers entered into agreements that

required sellers to pay taxpayer an amount equal to the down payment "gift" that the buyer received under taxpayer's DPA program.

In essence, these transactions result in a circular flow of the money. The sellers make payments to taxpayer. Taxpayer provides the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller's home. The seller receives the funds back in the increased sales price of the house.

The XXXXX Program Participating Home Agreement states, in part, that:

> Seller understands that this contribution will not be used to provide downpayment assistance to the buyer of the participating home, and that assistance provided to the buyer towards the purchase of the seller's home are derived from pre-existing XXXXX funds. Seller further understands that the contribution will only be requested, if a homebuyer utilizing the XXXXX Program purchases a home.

A "participating home" is a home owned by a seller willing to enter into a Participating Home Agreement (Resale Home) or a New Housing Services Agreement (Newly Built Homes) with XXXXX.

A section of XXXXX's "Program summary and guidelines" indicates that the seller is only obligated to make the contribution if a XXXXX Program buyer purchases the subject property and successfully closes and records. The seller is not obligated to make the contribution if the sale is not completed.

The contract also provides that agents should include the following language in the sales agreement: "This contract is contingent upon buyer receiving up to 5% gift funds from the XXXXX Program. The seller agrees to the terms and conditions of the attached participating."

XXXXX claims, in accordance with the provisions of the home agreement set forth above, that the seller's payment was not provided directly to the buyer, but instead was used to "replenish" the pool of funds that was used to provide "gifts" to subsequent buyers. The Organization's website states "the program does not use seller's money to contribute to the buyer's down payment. The contribution requested is not used for down payment assistance for that seller's property. Funds are deposited into escrow on behalf of the purchase prior to closing from existing XXXXX funds." However, a review of documents during the examination indicated that the identical amount of gift "contributed" by the seller was wired to the closing for that seller's buyer.

XXXXX does not solicit outside public contributions or have any source of funds other than "contributions" from sellers and related fees. The amount of the "contribution" is always equal to the amount of the down payment assistance provided to the buyer plus the service fee. The two transactions occur at the same time during closing. Moreover, XXXXX does not have any

excess fund to cover such payments. Therefore, the actual source of the down payment assistance is, in fact, the seller's "contribution."

Despite the representations in its application for exemption, taxpayer 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 taxpayer did not include data on the buyers' incomes and gave no indication that the Organization screened on such data. In an interview with the president, he indicated that income levels are not relevant. XXXXX's program provided "gifts" to any homebuyers who qualified for a loan regardless of need.

XXXXX's promotional materials and advertising make it clear that anyone who could qualify for some type of loan was eligible for the down payment assistance program. For example, one piece of promotional literature states: "No income limits", "Buyer must obtain an acceptable conventional or government loan program". Another states that "The XXXXX Program simplifies the down payment assistance process requiring less documentation and inspections than other similar entities."

In its contract with each seller, XXXXX also falsely and fraudulently labeled the seller's payment to taxpayer as both a "gift" and a "contribution." These contracts obligate the seller, in consideration for participating in XXXXX's program, to pay the Organization an amount equal to the amount of the DPA received by the buyer. The contract, which was required to be signed by each participating seller, states: "Seller further understands that the seller is only obligated to make the contribution if a home buyer utilizing the XXXXX program purchases the participating home." The IRS determination letter on the XXXXX website stated in part that "....Donors may deduct contributions to you only to the extent that their contributions are gifts with no consideration received... ." XXXXX 's president verbally informed the IRS that the Organization does not provide any tax advice to sellers on the deductibility of the contributions. However, the combination of posting the IRS determination letter on XXXXX's website and labeling sellers' payments to XXXXX as gifts and contributions would lead sellers to conclude that such payments were deductible for tax purposes.

The website materials indicate that XXXXX "recognizes housing counseling as a critical component of its strategy to help American households achieve the dream of home ownership. This counseling increases the likelihood that home buyers will make wise decisions in purchasing a home and will have a better chance of holding on to their homes over the long run." Despite this representation, there were no records of any counseling services provided or any enforcement of a requirement that buyers complete any educational module since this program began.

Parties that Benefited from XXXXX's DPA Program

In addition to the benefit to the sellers, buyers, realtors, builders and lenders, described above, certain individuals and entities also were the intended beneficiaries of XXXXX's operations during the years examined, as follows.

XXXXX: In , XXXXX loaned $ to a XXXXX. There was no written agreement between the parties. As of December 31, , the general ledger still shows the loan as outstanding.

XXXXX: The review of the bank statements indicated that some of the accounts into which XXXXX's funds were deposited were accounts opened in the name of XXXXX, XXXXX's founder and president. The organization's funds are, thus, commingled with the officer's funds and are available for his use. This does not indicate a good internal control system.

Sellers: The seller benefited by selling their home on time, selling at the home's full listed price and probably at a higher price to accommodate the "gift" to the EO/buyer.

Realtors: The realtors are able to increase their business, as more buyers and sellers are introduced into the program; sales increases thus increasing their commission.

XXXXX has no adequate internal controls. XXXXX controls all bank accounts and is the only signatory on the checks. The board of directors is made up of XXXXX and XXXXX. In addition to being directors, XXXXX is also XXXXX's president and secretary/treasurer; XXXXX, the Vice President. The board meets once a year. In and it conducted the following business:

minutes:

RESOLVED, the meeting was declared open for the election of officers. Upon motion duly made and seconded, the following persons were unanimously elected as officers of the corporation, to serve until the next annual meeting and/or until their successor(s) are elected and qualified:

XXXXX – President
XXXXX – Vice President
XXXXX – Secretary/Treasurer

Resolved Further, XXXXX shall continue to serve on the Board of Directors.

The directors hereby execute this consent in lieu of holding, conducting and attending a meeting and authorize and direct the officers of the corporation to take all action necessary and proper to effectuate such resolutions; and hereby state that this Consent shall have the same force and effect as a unanimous vote of directors at any director's meeting.

minutes:

Fundraising – Different methods of networking were discussed along with alternate fundraising practices. It was decided that other fundraising practices would be researched by members of the board.

LAW

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings of such corporations inures to the benefit of any private shareholder or individual. See § 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Section 1.501(c)(3)-1(d)(2) defines the term "charitable" for § 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education.

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

Section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business.

In Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.), the U.S. Court of Federal Claims considered whether an organization that provided prenatal care and

other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under § 501(c)(3). The court concluded that the organization did not qualify for exemption under § 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman's child sponsored the care financially. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in § 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of § 1.501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner." American Campaign Academy, 92 T.C. at 1077.

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the Tax Court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of § 501(c)(3). The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence collected by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from communities of craftsmen. The organization did not market the kind of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged.

The court concluded that the overall purpose of the organization's activity was to benefit disadvantaged communities. The organization's commercial activity was not an end in itself but the means through which the organization pursued its charitable goals. The method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in § 501(c)(3).

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

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

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

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

Rev. Rul. 70-585, 1970-2 C.B. 115, discussed four situations involving organizations that provided housing and the issue of whether each qualified as charitable within the meaning of § 501(c)(3).

Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not

qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

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

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

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

In early 2006 the IRS issued Revenue Ruling 2006-27, which describes three organizations involved in providing down payment assistance and determines whether each qualifies for exempt status under § 501(c)(3).
The organization described in Situation 1 makes assistance available to low-income families to purchase decent and safe 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 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 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 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(c)(3).

Benefiting Private Interests

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

An organization does not serve a public rather than a private interest within the meaning of Reg. 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.

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. Parker v. Commissioner, 365 F.2d 792, 799 (8th Cir. 1966); Kenner v. Commissioner, 318 F.2d 632 (7th Cir. 1963); Church of Scientology v. Commissioner, 823 F.2d 1310, 1316-17, 1319 (9th Cir. 1987).

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.

The prohibition on inurement in § 501(c)(3) is absolute. The Service has the authority to revoke an organization's exempt status for inurement regardless of the amount of inurement. See Spokane Motorcycle Club, supra; The Founding Church of Scientology, 412 F.2d at 1202

Promoting improper charitable contribution deductions

Section 170(a)(1) allows as a deduction, subject to certain limitations and restrictions, any charitable contribution (as defined in § 170(c)), payment of which is made within the taxable year.

Section 170(c) defines a charitable contribution as a contribution or gift to or for the use of an entity described in one of the paragraphs of §170(c). Section 170(c)(2) describes certain entities organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Generally, to be deductible as a charitable contribution under §170, a transfer to a charitable organization must be a contribution or gift. A charitable contribution is a transfer of money or property without receipt of adequate consideration, made with charitable intent. United States v. American Bar Endowment, 477 U.S. 105, 117-18 (1986). A payment generally cannot be a charitable contribution if the payor expects a substantial benefit in return. American Bar Endowment at 116-117; see also Singer Co. v. U.S., 449 F. 2d 413, 423 (Ct. Cl. 1971).

Substantial benefits are those that are greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely incidental to the transfer). Id.

Section 102 provides that the value of property acquired by gift is excluded from gross income. A gift "proceeds from a 'detached and disinterested generosity,' ...'out of affection, respect, admiration, charity or like impulses.'" Commissioner v. Duberstein, 363 U.S. 278, 285 (1960). Payments that proceed from "the constraining forces of any moral or legal duty," or from " 'the incentive of anticipated benefit' of an economic nature," are not gifts. Id. Thus, payments attendant to ordinary business or commercial transactions, or that proceed primarily from the moral or legal obligations attendant to such transactions, are not gifts.

Organizations that promote tax avoidance schemes do not qualify for exemption under section 501(a) as organizations described in section 501(c)(3). See Church of World Peace, Inc. v. Commissioner, T.C. Memo 1994-87 (1994), aff'd, 52 F.3d 337 (10th Cir. 1995). In Church of World Peace the church used its tax-exempt status to create a circular tax-avoidance scheme. Individuals made tax-deductible charitable donations to the church. The church then returned the money to the individuals in the form of tax-free "housing allowances" and also reimbursed the individuals for "church expenses" that were in fact unrelated to church operations. The church emphasized tax advice in connection with this tax-avoidance scheme. The Tax Court held, and the Tenth Circuit affirmed, that the church did not comply with the requirements of § 501(c)(3) because, by promoting a circular flow of funds from donors to the church and back to the donors and facilitating improper charitable contribution deductions, the church did not operate exclusively for exempt purposes enumerated in § 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, §14.01 (cross-referencing §13.01 et seq.), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, §13.02, 1990-1 C.B. 514.

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

GOVERNMENT'S POSITION AND ANALYSIS

XXXXX does not qualify as an organization described in I.R.C. § 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), (2) provides substantial private benefit to persons who do not belong to a charitable class; (3) results in inurement of a portion of the Organization's net earnings to the benefit of insiders; and (4) violates the requirements of § 501(c)(3) by promoting improper charitable contribution deductions.

Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of the regulations. XXXXX'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 does not serve exclusively low-income persons. Despite the representations in its application for exemption, XXXXX does not have any income limitations for participation in its DPA program. XXXXX does not screen applicants for down payment assistance based on income. The Organization's records do not include any data regarding the buyers' incomes. Instead, the program is open to anyone, without any income limitations, who otherwise qualifies for loans. Our analysis showed that, in fact, for the years at issue XXXXX's DPA program provided down payment assistance to anyone who applied, regardless of income or whether the purchaser was a first time buyer.

XXXXX'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 I.R.C. § 501(c)(3).

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if XXXXX's DPA program were directed to exclusively low-income individuals or disadvantaged communities, taxpayer'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), XXXXX is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in taxpayer's DPA program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market. They also benefit by being able to sell their home at the home's full listed

price or by being able to reduce the amount of the negotiated discount on their homes. Buyers who participate in the Organization's DPA program benefit by being able to purchase a home without having to commit more of their own funds.

Real estate professionals who participate in XXXXX'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 XXXXX's DPA program provides ample private benefit to the various parties in each home sale.

The manner in which XXXXX operated its DPA program shows that the private benefit to the various participants in taxpayer's activities was the intended outcome of taxpayer's operations rather than a mere incident of such operations. XXXXX'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, XXXXX 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 in Revenue Ruling 2006-27, XXXXX neither solicits nor receives funds from other sources. Before providing down payment assistance, XXXXX takes into account whether there is a home seller willing to make a payment to cover the down payment assistance the applicant has requested. XXXXX 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.

XXXXX secures an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless XXXXX is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing. XXXXX's instructions to title and escrow companies provide that at the close of escrow the seller's contribution, along with any XXXXX's fees, must be sent to XXXXX within 72 hours. XXXXX may elect to discontinue its relationship with a closing office who fails to comply with any XXXXX funding requirements. XXXXX's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of XXXXX's operations. In this respect, XXXXX is like the organization considered in Easter House that provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially.

XXXXX's promotional material and its marketing activities show that XXXXX operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in § 501(c)(3). The manner in which XXXXX operated its DPA program shows that XXXXX was in the business of facilitating the

sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect XXXXX's operations were similar to an organization that 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), XXXXX's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. XXXXX provided services to home sellers for which it charged a market rate fee. XXXXX did not market its services primarily to persons within a charitable class. XXXXX's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. XXXXX 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 v. U.S., 12 Cl. Ct. 476. A substantial part of XXXXX's activities furthered commercial rather than exempt purposes.

During the years under examination, XXXXX's president had unfettered control over the organization and ready access to the organization's assets, including cash, at any time. XXXXX, being the only signatory on all of XXXXX's bank accounts, had complete authority over the Organization's accounts. Internal controls were lacking. There was no outside community-based board of directors. The board consisted only of XXXXX and one other individual, XXXXX. As a board it had no involvement in the organization's affairs. The two directors merely approved, retroactively, all transactions that occurred during the year and elected themselves for another term. This is demonstrated by the one page minutes for the annual meeting, the only documentary evidence that the board took any action during the years under examination. This lack of oversight by the board may allow inurement to occur. Parker v. Commissioner, 365 F.2d at 799 ; Kenner v. Commissioner, 318 F.2d 632; Church of Scientology, 823 F.2d at 1316-17, 1319. Based on the foregoing, XXXXX has not operated exclusively for exempt purposes and, accordingly, is not entitled to exemption under § 501(c)(3).

XXXXX is also not entitled to exemption under § 501(c)(3) because it promoted improper charitable contribution deductions. A payment of money generally cannot be deducted as a charitable contribution if the payor expects to receive a substantial benefit in return. A seller's payment to XXXXX is not tax deductible as a charitable contribution under § 170 because the seller receives valuable consideration in return for the payment. In addition, the seller's payment to XXXXX is not tax deductible to the seller because the payment is compulsory. Furthermore, the payments from the home sellers to XXXXX also do not qualify as gifts under § 102. The payments from the home sellers do not proceed from detached and disinterested generosity but, rather, in response to an anticipated economic benefit, namely facilitating the sale of the seller's home. Under Commissioner v. Duberstein, 363 U.S. 278 (1960), such payments are not gifts for purposes of § 102.

The government proposes revoking XXXXX's exemption back to 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 January 02, , XXXXX represented that its purpose was to "provide down payment assistance program for low income individuals and families ... ." and that its "down payment assistance will be provided only to individuals who have a financial need for such services, and who complete the educational requirements designed to increase the likelihood of permanent home ownership." Despite these representations in its Application, XXXXX does not have any income limitations for its DPA program and does not screen applicants for down payment assistance based on income. The records provided by XXXXX did not include data on the buyers' incomes and gave no indication that XXXXX screened on such data. Rather, XXXXX's DPA program provided "gifts" to any homebuyers who qualified for a loan. In addition, XXXXX's application for exemption stated that it would obtain funds from many different sources, none of which were home sellers. However, as discussed above, nearly all of XXXXX's revenues have come from home sellers. Furthermore, although XXXXX has an educational requirement/information on its website, there was no indication that XXXXX obtained verification from buyers that they had reviewed or completed the educational course.

Revocation of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01. XXXXX's operation of its DPA activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of XXXXX's determination letter.

CONCLUSION

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

XXXXX operates in a manner indistinguishable from a commercial enterprise. XXXXX's primary activity is brokering transactions to facilitate the selling of homes. It appears that XXXXX's primary goal is to maximize its fees from these transactions. XXXXX's brokering services are marketed to homebuyers, sellers, realtors, lenders, home builders, and title companies regardless of the buyers' income levels or need and regardless of the condition of the community in which the home is located. Alliances are built with the realtors, lenders,

home builders, and title companies to ensure future business for the mutual private benefit of the participants.

Although XXXXX has an educational information/course on its website, the Organization provided no evidence that it obtained verification from buyers that they had reviewed or completed the educational module. XXXXX does not engage in any counseling or other activities that further charitable purposes. Because XXXXX's primary activity is not conducted in a manner designed to further § 501(c)(3) purposes, XXXXX is not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

In addition, a private loan was given to XXXXX for undisclosed purpose. XXXXX's president has unfettered control over the organization and ready access to the organization's assets, including cash, at any time because funds are deposited into accounts opened in his name and because he is the sole signatory on XXXXX's accounts. If this lack of internal control continues, it may result into inurement of organization assets to insiders. All of this constitutes evidence that assets and/or earnings of XXXXX inured to XXXXX's insiders in violation of the requirements of § 501(c)(3).

XXXXX is also not entitled to exemption under § 501(c)(3) because it promoted improper charitable contribution deductions.

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that XXXXX 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:

The Organization's position regarding the issues, facts, applicable law and the government's position as discussed in this report is unknown.