

Internal Revenue Service
TEGE Appeals Division
1352 Marrows Rd
Newark, DE 19711

CERTIFIED

Department of the Treasury

Release Number: **200921042**
Release Date: 5/22/09

Date: FEB 23 2009

Taxpayer Identification Number:

C

Person to Contact:

A

Employee ID Number:

Tel:

Fax:

B

Refer Reply to:

AP:LA:EMW

In Re:

Exempt status

Tax Years: and

subsequent years

UIL Index:

501.03-00

501.33-00

Last Day to File a Petition with the
United States Tax Court: **MAY 26 2009**

Dear :

This is a final adverse determination as to your application for exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reason(s):

A substantial part of your proposed activities consists of providing down payment assistance to home buyers. To finance the assistance you propose to rely on home sellers and other real estate related businesses that stand to benefit from these proposed down payment assistance transactions. Your receipt of a payment from the

home seller apparently will correspond to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you plan to operate demonstrates you will operate primarily to further business interests of home sellers and other real estate related businesses and professionals. Therefore, you plan to operate for a substantial nonexempt purpose. In addition, your proposed operation would further the private interests of the persons that finance your activities. Accordingly, you have not established that you will operate exclusively for exempt purposes described in section 501(c)(3).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown 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 form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

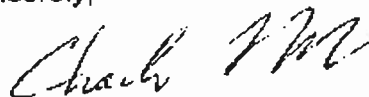
You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for Taxpayer Advocate assistance.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate, can however, see that a tax matter, that may not have been resolved through normal channels, gets prompt and proper handling.

We will notify the appropriate State officials of this final adverse determination of your exempt status, as required by Code section 6104(c).

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

Sincerely,



Charles F. Fisher
Appeals Team Manager



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D. C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date:

Contact Person:

LEGEND

ORG = Organization name XX = Date XYZ =
State Address = address Motto = motto
CO-1 = 1st company website = website

ORG

Identification Number:

ADDRESS

Contact Number:

FAX Number:

Employer Identification Number:

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Facts:

You, ORG, are a XYZ nonprofit organization, formed on January 26, 20XX. Your Articles of Incorporation state that you are organized exclusively for charitable, educational and/or scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code of 1986.

Your application Form 1023 states that your program will provide gifts of up to three percent of the contract sales prices. You will seek qualified low and moderate income home buyers who do not have the necessary funds for the down payment of their home purchase. You state that expected this program to begin operations on February 1, 20XX. You also state that the "program will charge home sellers and builders a service fee of 4% of the contract sales price to allow them to participate in the program, these fees will insure an on going source of income for future gifts to low and moderate income home buyers". You have stated that the down payment assistance program and the related solicitation of fees will constitute 90% of your overall activities.

You have also stated that the organization will "set up seminars to educate sellers as to how the program will help sellers sell property to a qualified buyer who does not have the funds for a down payment. This activity will constitute the remaining 10% of your overall activities.

You indicate on the Form 1023 application that the down payment assistance program is for the sole benefit of low to moderate income home buyers that demonstrate a need for financial assistance in purchasing a residence. However, your letter dated September 28, 20XX indicates that you do not limit participation in your program based on the income or assets of the buyer. Specifically, you state that "the program is self-regulating. Generally speaking, if the buyer can afford the down payment there is no need for him or her to apply for a grant". In addition, you have stated that you do not require buyers to use any particular loan program. Specifically, you state that by the time you receive the application the purchase price has already been agreed upon by the buyer and seller and approved by the lender. You state that you do not "agree to provide any funds until the lender has approved an outside third party appraisal through their internal appraisal review department and clears the loan to close".

You state that a typical down payment assistance transaction includes the following steps:

1. Leading up to the sale, you provide information to potential participants on the down payment assistance program.
2. When the participants have found the property and have a contract, the participants contact you and submit the appropriate application.
3. You review and process the application.
4. If the participant's application is approved, then funds are provided at closing.
5. If a grant is made, the seller is required to make a payment to you, which covers the amount of down payment assistance and a processing fee.

Your September 28th letter also indicates that the amount of the down payment assistance given to the buyer is determined by the financial needs of the buyer and the amount required by the lender. You have also stated that any grant made is subject to the approval of the seller and the lender; and that you will not provide down payment assistance to buyers if the seller's contribution is less than the required down payment amount.

Your letter dated September 28, 20XX included a "Motto" and an "Agreement". The "Motto" includes information regarding all parties involved in the transaction (buyer, seller, broker/lender, selling agent and closing agent). It also includes the amount of the gift and the service fee, and details about the subject property. The "Agreement" is signed by both the buyer and seller and states that you "provide assistance to homebuyers from an existing pool of funds". By signing the "Agreement", the seller agrees to pay the service fee and instructs the settlement agent to retain and immediately forward the service fee and any unused gift funds to you immediately upon completion of settlement. The "Agreement" also states that the seller is under "no obligation for said service fee if the buyer(s) fail to close on the purchase of the subject property. The fee is only made upon the successful closing of this transaction." The seller acknowledges that "the service fee is not to be used to provide gift funds to the Buyer for the subject property and the gift funds are derived from a preexisting pool of funds". The "Agreement" also states that repayment of the gift funds is not required or expected.

In your September 28th letter, you represent that you prevent sellers from inflating the sales price of their house by ensuring that the lender has approved an outside third party appraisal. However, you "do not determine list prices or sale prices" and there is no indication that you review the sales prices of the homes. In addition, you state that you do not research how many homes in your program are sold at a higher price than the initial sales prices or how long a home is on the market before the seller decides to participate in your program.

The financial data that you included in your Form 1023 shows that you anticipate having approximately \$ and \$ in contributions for the years ending December 31, 20XX and December 31, 20XX, respectively, and \$ and \$ in gross receipts from services for the years ending December 31, 20XX and December 31, 20XX, respectively. You anticipate making gifts of \$ and \$ for the years ending December 31, 20XX and December 31, 20XX, respectively.

You have stated that you promote your program through word of mouth to homebuyers, real estate professionals, realtor associations, mortgage professionals and mortgage associations. Your letter of September 28, 20XX included a sample copy of a solicitation letter that states "please direct your home buyers to us if they are short on the cash (and) they need to purchase a home. Moreover, direct your home sellers to our program so they can have their homes included in our program and accept CO-1, Inc. buyers."

You state in your response dated September 28, 20XX, that you continually promote the homebuyer's down payment assistance program. The seller contribution replenishes and increases the fund. At this time, no other fund-raising is planned.

You state that the "only services offered are down payment assistance and the provision of information on how the down payment assistance program works. You educate these individuals on how your program can allow them to purchase a home they otherwise could not afford. As mentioned above, your Form 1023 application mentions that you will also set up seminars to educate sellers as to how the program will help sellers sell property to a qualified buyer. Your September 28th letter also states that you are "in the process of exploring programs which would increase [your] services, such as an insurance program that assists buyers if they suffer the loss of a job, that may provide payment of their mortgage for up to 6 months". However, there is no indication that any of these seminars or programs have begun. You have indicated that you do not provide any services to the buyer following the closing on the sale of the home; but you "are available to answer any questions they may have".

The manner in which you operate is referred to as "seller-funded downpayment assistance" in the Final Report: An Examination of Downpayment Gift Programs Administered by Non-Profit Organizations, commissioned by Office of Housing, United States Department of Housing and Urban Development, HUD (March 1, 20XX). The report concludes that seller-funded down payment assistance for mortgage down payments has led to underwriting problems that require immediate attention. Furthermore, the report concludes that the effective costs of homeownership are increased even more by the processing fees charged by the seller-funded down payment assistance providers which get passed through to borrowers in higher property prices. A copy of the report is enclosed with this determination letter.

Law:

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

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes if it engages primarily in activities that accomplish

exempt purposes specified in section 501(c)(3) of the Code. An organization must not engage in substantial activities that fail to further an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized and 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 and operated for the benefit of private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" as used in section 501(c)(3) of the Code as including the relief of the poor and distressed or of the underprivileged. The term "charitable" also includes the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations provides, in part, that the term "educational" as used in section 501(c)(3) of the Code 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) of the regulations 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) of the Code if the trade or business furthers an exempt purpose, and provided the organization's primary purpose does not consist of carrying on an unrelated trade or business.

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 of importance of truly . . . [exempt] purposes."

In Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), *aff'd*, 846 F. 2d 78 (Fed. Cir.) *cert. denied*, 488 U.S. 907 (1988), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. 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. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in section 501(c)(3) of the Code because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with Republican Party entities and that most of the organization's graduates worked in campaigns for Republican candidates. Consequently, the court concluded

that the organization conducted its educational activities with the objective of benefiting Republican 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 section 1.501(c)(3)-1(d)(1)(ii) of the regulations. The court concluded by stating that even if the Republican 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."

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops be operated for exclusively charitable purposes within the meaning of section 501(c)(3) of the Code. 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 the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from these communities of craftsmen. It did not select individual craftsmen based on the needs of the purchasers. The court concluded that the overall purpose of the activity was to benefit disadvantaged communities. The method it 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.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 20XX), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. "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."

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

Rev. Rul. 70-585, 1970-2 C.B. 115, discusses four examples of organizations providing housing and whether each qualified as charitable within the meaning of section 501(c)(3) of the Code. Situation 1 describes 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 provides financial aid to eligible families who do not have the necessary down payment. 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 holds that by providing homes for

low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 describes 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 is made available to members of minority groups who are unable to obtain adequate housing because of local discrimination. The housing units are 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 holds that the organization was engaged in charitable activities within the meaning of section 501(c)(3) of the Code.

Situation 3 describes 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 was generally old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area; it sponsored a renewal project; and involved residents in the area renewal plan. The organization also purchased apartment buildings 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 holds that the organization is described in section 501(c)(3) of the Code because its purposes and activities combated community deterioration.

Situation 4 describes 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 Service held that the organization failed to qualify for exemption under section 501(c)(3) of the Code because the organization's program did not provide relief to the poor or further any other charitable purpose within the meaning of section 501(c)(3) and the regulations.

Rev. Rul. 72-147, 1972-1 C.B. 147, holds that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) of the Code because it gave preference to employees of a business operated by the individual who also controlled the organization. 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.

Rationale and Conclusion:

Based on the information you provided in your application and supporting documentation, we conclude that you are not operated for exempt purposes under section 501(c)(3) of the Code. An organization cannot be recognized as exempt under section 501(c)(3) unless it shows that it is both organized and operated exclusively for charitable, education, or other exempt purposes.

Among other things, the application and supporting documentation must demonstrate conclusively that the organization meets the operational test of section 1.501(c)(3)-1(c) of the regulations. Your information indicates that your primary purpose is to operate a down payment assistance program that does not exclusively serve a purpose described in section 501(c)(3).

Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of

the regulations. However, you do not conduct your down payment assistance program in a manner that establishes that your primary purpose is to address the needs of low-income grantees by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1.

Your down payment assistance program does not serve exclusively low-income persons. Instead, your program is open to low and moderate income individuals. You have not demonstrated that your down payment assistance program exclusively serves any other exempt purpose such as combating community deterioration and lessening racial tensions. You indicated that you do not specifically target the benefits of your program towards any one disadvantaged group. For example, you have not shown that your program is designed to attract a mixed-income group of homeowners to a specifically defined geographical area that has a history of racial problems. See Rev. Rul. 70-585, Situations 2 and 3

Your information indicates that you do not limit your assistance to certain geographic areas or target those areas experiencing deterioration or racial tensions. See Rev. Rul. 70-585, Situation 4. Arranging the purchase of homes in a broadly defined metropolitan area does not combat community deterioration within the meaning of section 501(c)(3) of the Code.

Furthermore, you do not engage in any activity to ensure that the house will be habitable or that the buyer will be able to afford to maintain the house over time. Instead, you rely solely on the mortgage lender, insurance agency, home inspector or other third party to conduct such review. You do not provide oversight or conduct any educational program or other activity to ensure that buyers are purchasing properties that are safe, decent, sanitary, and affordable.

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, *supra*, 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. You conduct your operations in a manner that is 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 a charitable class or the public at large. The manner in which you operate your down payment assistance program indicates that you facilitate the sales of homes in a manner that is indistinguishable from an ordinary trade or business. You operate as a business that provides services to home sellers for which you charge a market rate fee. It is clear that the fees received from the home seller are connected to the sale of their home because you indicate that the seller is not obligated to pay the fee until the time of settlement and that they will not be required to pay the fee if the sale transaction does not close. In this respect you are similar to an organization which was denied exemption because it operated a conference center for a commercial purpose. See Airlie Foundation, Inc. v. U.S., 283 F. Supp. 2d 58 (D.D.C., 2003). Likewise, operating a trade or business of facilitating home sales is not an inherently charitable activity. Thus, a substantial part of your activities further a nonexempt purpose.

Another indication of your substantial nonexempt purpose is your lack of public support. You are not supported by contributions from the general public, government or private foundation grants. Primarily all of your revenue is expected to come from the sellers you serve. That your primary activity is to promote and to further your private business interests is reflected in the financing structure of your down payment assistance program. In this respect you are similar to

the organization described in Easter House, *supra*, which derived most of its support from fees it charged for its adoption services. In this case, the court stated that the substantial fees were not incidental to the organization's exempt purpose because they were designed to make a profit. Facilitating home sales, like running an adoption service, is not an inherently charitable activity, and receiving support primarily from fees charged to home sellers is indicative of your commercial purpose.

Even if your program would be directed to exclusively low-income individuals, your reliance entirely on home sellers or other real-estate related businesses that stand to benefit from the transactions to finance your down payment assistance activities demonstrates that you are operated for the purpose of benefiting private parties.

Your grant making procedures indicate that gift funds are only provided to the buyer if a seller has paid a service fee. The sellers will make the payments to you and indirectly to the homebuyer to facilitate the sale of their homes. Upon the closing of the sale, the sellers "service fee" to you is returned to the seller as part of the proceeds the seller receives from the sale of the home.

Your information clearly indicates that you take into account whether there is a home seller willing to make a payment to cover the down payment assistance an applicant has requested. That you receive a payment from the home seller corresponding to the amount of the down payment assistance plus the service fee indicates that the benefit to the home seller is not a mere accident but rather an intended outcome of your operations. In this respect, you are like Easter House, *supra*, which provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially. Similar to American Campaign Academy, *supra*, you are structured and operated to directly benefit the home sellers who pay for your services. Therefore, a substantial part of your activities serve a private rather than a public interest.

Based on the facts and information submitted, you are not operated exclusively for exempt purposes. You have not established that you activities exclusively serve a charitable class or any other purpose defined in section 501(c)(3). Your proposed operations further a substantial nonexempt business purpose and will further the private interests of home sellers and other private parties. In addition, you have not established that your net earnings will not inure to the benefit of private shareholders or individuals. Therefore, you are not described in section 501(c)(3) of the Code.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter.

We will consider your statement and decide if that information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to

our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. To be represented during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at website Forms and Publications.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter to you. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to the applicable address:

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements