



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Release Number: **201007069**

Release Date: 2/19/10

LEGEND

ORG = ORGANIZATION NAME

XX = DATE

ADDRESS = ADDRESS

November 24, 2009

UIL Code: 501.03-00

ORG

ADDRESS

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN:

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: February 22, 20XX

Dear

This is a Final Adverse Determination Letter as to your exempt status under section 501(c) (3) of the Internal Revenue Code. Per your signed agreement on November 6, 20XX, your exemption from Federal income tax under section 501(c) (3) of the code is hereby revoked effective, January 1, 20XX.

Our adverse determination was made for the following reasons:

A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance you rely on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated primarily to further your insiders' business interests. Therefore, you are operated for a substantial nonexempt purpose. In addition, you operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in section 501(c) (3).

You failed to meet the requirements of IRC section 501(c) (3) and Treas. Reg. section 1.501(c) (3) -1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for the benefit of private interests and a part of your net earnings inured to the benefit of outsiders, your founder and board members...

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

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You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

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

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or writing to: Internal Revenue Service.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Sunita Lough
Director, EO Examinations

Internal Revenue Service

Department of the Treasury

TE/GE Division
450 Golden Gate Avenue MS SF 7-4-01
San Francisco, California 94102-3412

Date: May 29, 2007

Taxpayer Identification Number:

Form:
990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Adverse Action. We will send you a final modification or revocation letter.

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

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

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

Letter 3618 (Rev. 11-2003)
Catalog Number: 34809F

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

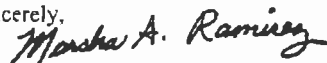
You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have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



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

Thank you for your cooperation.

Sincerely,



Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit #1
Name of Taxpayer ORG EIN:		Year/Period Ended 12/31/20XX

LEGEND

ORG = ORGANIZATION NAME XX = DATE STATE = STATE DIR-1, DIR-2 &
DIR-3 = 1ST DIRECTOR, 2ND DIRECTOR & 3RD DIRECTOR

ISSUES:

1. Whether an organization, whose primary purpose is operating a “down-payment assistance” program is operated exclusively for charitable purposes within the meaning of IRC 501(c)(3)?

FACTS:

ORG was incorporated in the State of State, on April 24, 20XX. The corporation was formed under the nonprofit laws for the promotion of social welfare within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986. The corporation’s initial directors were DIR-1, DIR-2, and DIR-3.

The foundation filed Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code in 20XX. The application was signed by DIR-1, President, on May 5, 20XX.

In Part II of the application, ORG stated that it intended to encourage and assist low-income families to become homeowners by creating a system for such families to make initial downpayments on suitable homes. The organization planned to accomplish this by working in conjunction with the U.S. Department of Housing and Urban Development (“HUD”).

In Part II, Question 2, ORG stated that the primary source of support would consist of contributions and processing fees from sellers in the aggregate amount of approximately 4% of the contract sales price for properties sold through organization’s non-profit program.

In Part II, Question 3, the organization described its fundraising program. It stated that upon receipt of a determination letter, the officers intended to solicit charitable contributions from established contacts in the community to obtain sufficient funds in order to begin the downpayment program. “As a negotiated element of every transaction, Sellers will contribute, after closing, 3% of the contract sales price to our non-profit organization, and pay us a 1% processing fee for our services. Furthermore, we intend to rely on the integrity of our program to promote word-of-mouth marketing among Buyers and Sellers in order to sustain our future activities.”

In response to a letter from the IRS dated July 10, 20XX requesting clarification of any other activities, ORG stated that “We do not intend to participate in any other charitable activities

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other than the downpayment assistance program as outlined in our Form 1023 Application for Recognition.”

In the same letter, the IRS asked what kind of contributions would be required of homebuilders. The organization responded that “We intend to treat homebuilders as sellers under our business plan. Consequently, homebuilders that sell homes through our program will make a contribution and pay a processing fee to ORG in the aggregate amount of approximately 4% of the contract sales price of the property sold through our non-profit program.”

The Service issued a favorable determination letter to ORG on August 27, 20XX. The determination letter stated that ORG was exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). The letter also determined that the organization was not a private foundation with the meaning of section 509(a) of the Code, because it was described in sections 509(a)(1) and 170(b)(1)(A)(vi).

The organization’s guidelines state that “Gift Funds” are monies offered by ORG to low-income buyers. “The gift funds are offered towards the purchase (downpayment and closing costs) of a participating home anywhere in the United States.” The guidelines also state that “Mortgage Originators or qualified Closing Agents (e.g., a settlement agent, closing attorney, escrow officer, or title company representative) may request gift funds on behalf of low-income buyers with a Gift Application.”

ORG provides Mortgage Originators a standard method for requesting Gift Funds. Mortgage Originators, after acquiring the necessary information from the buyer, submit the Gift Application online or fax the Application to ORG. Once processed, this request allows the buyer to receive a gift amount equal to 3% of the contract sales price and closing costs (the “Gift”). After closing, the seller or homebuilder makes a donation to ORG for the exact amount of the Gift, and pays a flat processing fee of \$ to ORG.

An ORG participating home is described as “a home owned by a seller that has entered into a Participating Home Agreement/Contract Addendum with ORG. Most any home on the market can be purchased with funds from ORG if the seller agrees to participate. A participating home may be an existing home or a new home offered by a homebuilder.”

An “Overview” prepared by the organization states that “Sellers participate in this program since such a program dramatically increases the pool of potential Buyers, decreases time necessary to sell their property while their net return is comparable to that of a traditional sale.”

ORG filed Form 990 for the year ended December 31, 20XX, and reported contributions of \$. Program service revenue totaled \$. Combined with \$ of interest, total revenue was \$.

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Of the total revenue, \$ was disbursed as payments to low-income families for down payments on homes.

Based on the examination of the activities and financial information reported on the Form 990 return, ORG generated revenue and expended funds in furtherance of its sole activity, the operation of a down-payment assistance program. In Part III of the Form 990, the organization provided the following "Statement of Program Service Accomplishments: "The corporation's purpose is to assist low-income families in purchasing their own home by gifting the down payments."

Sellers that participate in the program are required to contribute an amount equaling 3% of the final sales contract as well as a \$ processing fee to ORG. "Specific assistance to individuals" reported on the Form 990 (\$) represented amounts disbursed by the organization to potential home buyers in the form of down-payment assistance. The organization engages in no activity other than seller financed down payment assistance.

The organization has stated in a letter to the Service dated October 16, 20XX "that once ORG learned that the IRS had issued its ruling regarding down payment assistance programs, ORG . immediately determined that it would no longer qualify for tax exempt status. The organization also stated that "ORG concedes that based upon IRS latest revenue ruling that seller funded down payment assistance programs, standing alone, would not qualify for tax exempt status." Beginning with the issuance of Revenue Ruling 2006-27, the organization began winding down its business operations. ORG currently has no continuing operations in providing down payment assistance or any other activity and is in the process of dissolving.

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 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

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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” as used in § 501(c)(3) 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” as used in § 501(c)(3) 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.

Easter House v. US., Cl. Ct. 476, 486 (1987), aff’d, 846 F. 2d 78 (Fed. Cir)

The US Court of federal claims considered whether an organization that provided an adoption and related health services to pregnant woman who agreed to place their newborns for adoption through the organization 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 operations of an adoption service which, in and of itself, did not serve an exempt purpose. The organization did not provide health-related services to unwed mothers who wished to keep their children or who arranged for an adoption independent of the organization. The organizations 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 education 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, 12Cl. CT. at 485-86.

American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989)

The court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with a particular political party and that most of the organizations graduates

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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 organizational "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 private interests within the meaning of § 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.

Columbia Park & Recreation Association v. Commissioner, 88 T.C. 1 (1987), aff'd. Without published opinion, 838 F.2nd 465 (4th Cir. 1988)

The court held that an association formed in a private real estate development to operate parks, swimming pools, boat docks and other recreational facilities did not qualify as § 501(c)(3) organization. Although the organization provided some benefit to the general public, the primary intended beneficiaries were the residents and property owners of the private development. Thus, the organization operated for a substantial non-exempt purpose rather than for exclusively charitable purposes.

Rev. Rul. 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is "charitable" 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 in obtaining improved housing, including (1) conducting a training course relative to various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Rev. Rul. 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and analyzed whether each organization 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 eligible for loans under a Federal housing program who 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.

Rev. Rul. 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low-income families did not qualify for exemption under § 501(c)(3) because it gave preference

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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.

Rev. Rul. 72-559, 1972-2 C.B. 247, held that an organization that subsidized recent law graduates during the first three years of their practice to enable them to establish legal practices in economically depressed communities that have a shortage of available legal services, and to provide free legal services to needy members of the community, qualified for exemption under § 501(c)(3). Although the recipients of the subsidies were not themselves members of a charitable class, the resulting benefit to them did not detract from charitable purposes. Rather, the young lawyers were merely the instruments by which the organization accomplished the charitable purpose of providing free legal services for those unable to pay for, or obtain, such services.

Rev. Rul. 74-587, 1974-2 C.B. 162, held that an organization providing low-cost or long-term loans to, or equity investments in, businesses operating in economically depressed areas qualified for exemption under § 501(c)(3). The organization provided financial assistance only to businesses that were unable to obtain funds from conventional sources, and gave preference to businesses that would provide training and employment opportunities for unemployed or underemployed area residents. Although some of the individual business owners receiving financial assistance from the organization were not themselves members of a charitable class, the benefit to them did not detract from the charitable character of the organization's program. As in Rev. Rul. 72-559, the recipients of aid were instruments for accomplishing the organization's charitable purposes.

Rev. Rul. 76-419, 1976-2 C.B. 146, held that an organization that converts blighted land in an economically depressed community to an industrial park and leases space on favorable terms to businesses that agree to hire a significant number of unemployed area residents and train them in needed skills qualifies for exemption under § 501(c)(3). The organization furthered charitable purposes by improving economic conditions for the poor and distressed and combating community deterioration. The organization offered inducements to businesses solely for the purpose of advancing charitable goals.

EXAMPLE:

Situation #2

Per Internal Revenue Bulletin 2006-21, May 22, 2006, Revenue Ruling 2006-27, under Y's grant making procedures, Y's staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the

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sale. Moreover, in substantially all of the cases in which *Y* provides down payment assistance to a home buyer, *Y* receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by *Y* in connection with each of these transactions and the amount of the home seller's payment to *Y*. Finally, *Y* does not conduct a broad based fundraising campaign to attract financial support. Rather, most of *Y*'s support comes from home sellers and real estate-related businesses that may benefit from the sale of homes to buyers who receive *Y*'s down payment assistance.

ANALYSIS:

Situation #2

Per Internal Revenue Bulletin 2006-21, May 22, 2006, Revenue Ruling 2006-27, *Y* does not qualify as an organization described in § 501(c)(3). To finance its down payment assistance activities, *Y* relies on sellers and other real-estate related businesses that stand to benefit from the transactions *Y* facilitates. Furthermore, in deciding whether to provide assistance to a low-income applicant, *Y*'s grant making staff knows the identity of the home seller and may also know the identities of other interested parties and is able to take into account whether the home seller or another interested party is willing to make a payment to *Y*. *Y*'s receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and *Y*'s reliance on these payments for most of its funding indicate that the benefit to the home seller is a critical aspect of *Y*'s operations. In this respect, *Y* is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any educational or charitable purpose. Like the organization considered in *American Campaign Academy*, *Y* is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in *American Campaign Academy*, *Easter House*, and *Columbia Park Recreation Association*, *Y* also serves an exempt purpose, but because *Y* is not operated exclusively for exempt purposes, *Y* does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

GOVERNMENT'S POSITION:

Internal Revenue Bulletin 2006-21, May 22, 2006, Revenue Ruling 2006-27, Situation #2, outlined above most closely identifies ORG's down payment assistance program. In its analysis, it clearly shows ORG not qualifying as an organization described in § 501(c)(3). To finance its down payment assistance activities, ORG relies on seller funding to finance its down payment assistance activities. The organization's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and ORG's reliance on these payments for most of its funding indicate that the benefit to the home seller is a critical aspect of the organization's operations. In this respect, ORG is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its

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primary goal and overshadowed any educational or charitable purpose. Like the organization considered in *American Campaign Academy*, ORG is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in *American Campaign Academy*, *Easter House*, and *Columbia Park Recreation Association*, ORG also serves an exempt purpose, but because ORG is not operated exclusively for exempt purposes, ORG does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

The conclusion that ORG is not operated as a “charitable” organization within the meaning of Federal Tax Regulations § 1.501(c)(3)-1(c) rests primarily on an analysis of its sources of revenue and its business activities. Based on the rationale described in Revenue Ruling 2006- 27 I.R.B. 2006-21, May 4, 2006, organizations that provide seller-funded down payment assistance to low-income homebuyers do not qualify as tax-exempt charities.

TAXPAYER’S POSITION:

DIR-1, President of ORG acknowledges that under current Revenue Ruling 2006-27, his organization no longer qualifies for tax exempt status. He is in the process of dissolving the corporation.

CONCLUSION:

ORG is not operated exclusively for charitable purposes, and, consequently, does not qualify for exemption from federal income tax as an organization described in I.R.C. § 501(c)(3) of the Internal Revenue Code and § 1.501(c)(3)-1(c)(1); § 1.501(c)(3)-1(d)(1)(ii); § 1.501(c)(3)-1(d)(2); § 1.501(c)(3)-1(d)(3)(i); § 1.501(c)(3)-1(e) of the Income Tax Regulations. Accordingly, the organization’s exempt status is revoked effective January 1, 20XX.