Internal Revenue Service
Appeals Office
1000 South Pine Island Road
Suite 350
Plantation, FL 33324

Number: **200935050**
Release Date: 8/28/2009

Date: February 25, 2009

UIL: 7428.00-00

Department of the Treasury

Person to Contact:

Employee ID Number:
Tel:
Fax:
Refer Reply to:
AP:Area 4:Team 5:GP
In Re:
EO Revocation
Form Required to be Filed:
1120
Tax Period(s) Ended:
June 30, 20XX
Last Day to File a Petition with the United States Tax Court: MAY 26 2009

Certified Mail

Dear :

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective July 26, 2002.

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, your 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. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

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 within 90 days from 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.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Sincerely,

CHARLES FISHER
TEAM MANAGER

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE Examinations
1100 Commerce Street
Dallas, TX 75242

Taxpayer Identification Number:

Org. Name

Form:
990
Tax Year(s) Ended:
June 30, 20XX
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:

401 W. Peachtree St.
Room 510 - Stop 202-D
Atlanta, GA 30308-3539

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. Rameriz
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

LEGEND
ORG = Organization name XX = Date XYZ = State City = city
Agent = agent Founder = founder BM-1, BM-2, BM-3 & BM-4 = 1ST, 2ND, 3RD & 4TH BOARD MEMBERS CO-1, CO-2, CO-3 & CO-4 = 1ST, 2ND, 3RD & 4TH COMPANIES NEWS-1, NEWS-2 & NEWS-3 = 1ST, 2ND & 3RD NEWSPAPERS

Issue:

Whether ORG operated exclusively for exempt purposes within meaning of Internal Revenue Code section 501(c)(3).

Facts:
ORG, (ORG) a XYZ not-for-profit corporation incorporated on October 29, 20XX. The stated purposes of the organization are (1) to make distributions to organizations that are designated as charitable organizations under Section 501(c)(3) of the Internal Revenue Code of 1986 as amended; (2) to provide down payment assistance to individuals of low to moderate income levels, first time homebuyers, displaced spouses, single parents and such other persons in need of down payment assistance; and (3) to provide education to first time homebuyers regarding home ownership and mortgage requirements, leasing, purchasing and selling any and all kinds of property in furtherance of the Corporation.

On February 25, 20XX, the ORG applied for recognition as a tax-exempt organization under section 501(c)(3) on Form 1023, Application for Recognition of Tax-Exempt Status. By letter dated July 26, 20XX, based on the information that the ORG provided in its Form 1023 and on the assumption that it would operate in the manner represented in its application, the ORG was recognized, as a tax-exempt organization as described in section 501(c)(3).

Since 20XX, the ORG has promoted and operated a Down Payment Assistance (DPA) program in which it provides funds to home buyers to use as their down payments and collects the same amounts, plus additional fees, from the home sellers. As more fully described below, under the ORG's DPA program, down payment assistance is provided for all types of housing loan programs, including federally insured mortgages, to buyers with no income or asset limitations except those imposed by the lenders. The organization did not provide documentation showing they provided seminars to educate the public regarding mortgages, personal finance, credit reporting and predetory lending as described in the 1023 application.

Application for Recognition of Tax-Exempt Status:
The Form 1023, Application for Recognition of Tax-Exempt Status, filed by ORG with the IRS described its activity as follows:

> The primary activity of ORG (the "Corporation") is to assist those individuals, who

have a reasonable credit history but are unable to save enough money to serve as a down payment, and also provide assistance to those who have poor credit history and are unable to obtain financing through conventional lenders.

ORG has developed several programs that it believes to be appropriate to accomplish the above referenced objectives. These include the following:

1. Down Payment Assistance: The ORG believes that quality and affordable housing is essential to the development of strong communities and recognizes that the lack of funds sufficient to serve as a down payment inhibits community development. The Federal Government, through various agencies including the Department of Housing and Urban Development, has expressly recognized these beliefs and adopted numerous programs to assist America's citizens, including home loan programs through the Federal Housing Administration and the Veterans' Administration. To provide additional assistance, the ORG has developed a program to make funds for down payments available to qualified participants, which shall primarily include low-income and very low-income individuals. The ORG will give an amount sufficient to serve as a down payment to qualified participants. To be "qualified," a participant must otherwise qualify for an FHA, VA or conventional loan. The ORG will cause its activities to comply with the Internal Revenue Service Revenue Procedure 96-32, and the ORG and has signed a Declaration of Compliance with Revenue Procedure 96032 which is attached hereto.

2. Education and Counseling: The ORG strongly believes that predatory lending largely occurs because borrowers simply are uneducated as to the lending process. In addition, the credit histories of many low-income and very low-income individuals reflect inaccuracies about which the individuals are not aware or are without the resources to resolve. As such, many individuals borrow money at exorbitant interest rates or from finance companies that engage in undesirable lending practices. These lending practices result in the fracturing of developing communities and the inhibition of community redevelopment efforts. To combat this, the ORG will conduct seminars throughout the communities in which it operates to educate the public regarding mortgages, personal finance, credit reporting, and predatory lending. These programs will be sponsored by the ORG in conjunction with local Community groups and other charitable organizations at the ORG's sole cost and expense. To teach these seminars, the ORG will request the assistance of experienced debt counselors, financial planners and advisors, certified public accountants, attorneys, mortgage brokers, bankers, and college and university professors.

Educational seminars conducted by the ORG will address various information necessary or helpful in the home-buying process. The ORG's goal is for each of its participants, as well as the general public, to understand the mortgage lending process and to know how to find appropriate and affordable housing. In addition, the ORG will provide information about credit reporting agencies, including general instructions on how to correct inaccuracies on credit reports and the rights and remedies of individuals under the Fair Credit Reporting Act. From time to time, the ORG, in addition to conducting various seminars, will provide individual credit counseling.

Finally, the ORG intends further to develop its existing website to provide online seminars, guidelines, articles and advice designed to educate the public regarding the dangers of high interest loans.

3. Community Reinvestment: The ORG firmly believes that strong communities promote a strong society and a strong nation. In addition, the ORG believes that strong communities are created by the active participation of each communities' residents. Unfortunately, many communities have encountered substantial challenges that have left community members unable successfully to build or rebuild desirable communities. As such, it is the responsibility of caring individuals and charitable organizations to assist in the rebuilding of our nation's communities.

Accordingly, the ORG will donate money to various 501(c)(3) organizations, including community organizations, religious associations and other charities that demonstrate the ability positively to impact our communities. To qualify for funding from the ORG, applicants must demonstrate a well-conceived and thorough plan to better their community. The ORG anticipates the recipients of its gifts will include such organizations as CO-1, the CO-2, the CO-3, the CO-4 and various other community reinvestment coalitions and associations.

The ORG, from time to time, anticipates contributing money to renovate buildings, build public parks and community centers and otherwise assist in areas traumatized by urban blight. For this work, the ORG may partner will local community organizations, cities, townships, states and development authorities to identify areas where the community may be best served and to implement a plan capable of promoting positive community development.

Fund Raising: The ORG will raise money for its programs by soliciting Contributions from community organizations and charitable organizations, requesting Contributions from individuals selling homes to participants in the ORG's homebuyer assistance program, and conducting fundraising drives. The ORG anticipates that many sellers may contribute to the ORG's charitable purpose, but no seller will be required to contribute in order for a participant to receive down payment assistance.

According to its Form 1023, the sources of financial support for ORG will be as follows in order of size:

- The organization believes it primary sources of financial support shall come in the form of contributions from individuals;
- Grants from various governmental agencies; and
- Grants from other 501(c)(3) organizations, as more fully set forth in the Organization's pro forma budget attached hereto and in the attached Schedule II-1.

Additional Information Requested

Additional information was requested from the ORG during the application process. The additional information requested and the responses provided during the processing of the Form 1023 were as follows:

1. Requested information:

You have indicated in your application for exemption that your organization's research demonstrates that communities of homeowners are safer, cleaner, and healthier than communities of renters. Please describe in detail your research activities and submit copies of research materials.

Response:

Founder, the founder of ORG (the ORG), previously worked for some time as a loan officer. During that time, he became aware of numerous problems encountered by those with low incomes and those located in communities in which the majority of residents have low incomes. Founder's research consists nearly exclusively of anecdotal information gathered during conversations with acquaintances and colleagues, together with information learned while reading through various publications.

2. Requested information:

You indicate that your organization will provide gift funds to assist homebuyers with their down payment.

a. Describe the class of potential recipients of your organization's gift funds. Describe any restrictions or limitations on who may apply or whom your organization will consider as possible grantees.

b. Please describe in detail the source of the gift funds.

Response:

2a. The ORG will provide gift funds in the form of down payment assistance to recipients who are otherwise unable to obtain a mortgage without resorting to financing through finance companies who offer loans with extremely high interest rates. The ORG cannot limit applicants who apply to receive benefits; however, the ORG is particularly interested in assisting individuals who have encountered hardship and can demonstrate their effort to overcome this hardship.

2b. The ORG will request contributions from various individuals involved in or concerned about predatory lending practices and the improvement of traditionally underserved communities. The ORG anticipates that it will request contributions from individuals selling residential real estate agents, mortgage companies, and other 501(c)(3) organizations. The ORG, from time to time, anticipates conducting fundraising drives and engaging in other efforts designed to raise community awareness of the impact of predatory lending practices.

3. Requested information: Please Submit a copy of the gift application.
   Response: See enclosed. [A copy of the gift application is attached to this report as Exhibit A.]

4. Requested information: Explain how the current officers were elected as the first board members. What experience do they have? Please explain.

   Response:

The ORG was born of a vision by Founder, the current president and executive director of the ORG. Founder was tremendously concerned about the impact of predatory lending practices on the communities surrounding and other metropolitan areas. Several reports by NEWS-1, NEWS-2, NEWS-3, and other newspapers demonstrated that the number of foreclosures on residential real estate has been increasing rapidly. Through these articles and numerous conversations with friends and colleagues, Founder became aware that many individuals are forced to borrow money at exorbitant rates in order to purchase reasonable housing. In the alternative, they may rent housing of dubious quality in neighborhoods that feature under-performing schools and decrepit infrastructure. In this type of situation, members of the community are trapped and without viable recourse. Founder determined that he would make a difference. Founder then began contacting individuals he knew to determine whether they were interested in participating in his vision. After speaking with several individuals, the initial board of directors of the ORG consisting of Founder, BM-1, BM-2 and BM-3 was selected. BM-2 recently resigned as a member of the board of directors, and the ORG's board has appointed BM-4 as a board member to take his place. Founder previously worked as a loan officer after working in the grocery business for more than twenty (20) years. In 20XX, he became impressed with the need to help his community and to assist hard working families achieve the dream of owning a home. He has taken a significant reduction in salary to make this opportunity work and open doors for people who may not have been able to purchase a home in the past. BM-1 has been a volunteer in his community for the past twelve (12) years, at which time he became wheelchair bound. He has a strong desire to help people and volunteers in many community projects, such as little league, at his local high school coaching. Wherever there is a need BM-1 is the first volunteer. He saw being on the board of the ORG as another way of helping people. BM-3 has worked and owned her own hair salon for more that fifteen (15) years and works well with the public. She is a great communicator and does a lot of volunteer work through her church. She also saw this as an opportunity to help the community and low-to-moderate income families achieve the dream of owning their own home. BM-4 is currently a warehouse manager in City, XYZ. He volunteers in his community for many projects, such as, but not limited to, little league, coaching soccer, coaching football for kids, and CO-1. He is a strong leader in his church and is always the first one to volunteer when help is requested for any project. He found out about the opportunity with the ORG through a friend and looked at it as another way to help people.

5. Requested information:

Will any officers, directors, members, or their relatives, receive a salary, reimbursement for expenses, or any other form of payment from your organization? If so, explain fully, and include the recipients' names, duties, and the number of hours each week that they will devote to such duties. State the amount of compensation each will receive and the basis for arriving at the amounts of such payment.

Response:

No officer, director, member, or their relatives will receive a salary from the ORG except as fair and reasonable compensation for services actually rendered to the ORG. Currently, Founder is active in the day-to-day operations of the ORG and devotes at least forty (40) hours per week to the ORG's activities. Founder maintains an office at the ORG's headquarters and approximately $ ($) in salary from the ORG, an amount far less than the salary to which he previously was accustomed. Officers, directors, and employees of the ORG may be reimbursed for expenses they incur on behalf of the ORG if they first obtain the ORG's written permission. The ORG expects that any such expenses will be minimal so as to devote as much as possible to the ORG's charitable endeavors.

6. Requested information:

Please explain how sellers are made aware of your organization.

Response:

The ORG anticipates communicating its ability and willingness to help through conducting community education seminars, developing and maintaining a website, and contracting civic minded individuals involved in residential real estate. When beneficiaries of the ORG's charitable endeavors identify a home they would like to purchase, the ORG will deliver information to the home seller regarding its charitable efforts and will request that the home seller make a contribution, nor will the gift of funds for down payment assistance to the beneficiary be affected.

7. Requested Information:

If your organization provides funds to a buyer in a real estate transaction, are sellers required to make a contribution or pay a fee to your organization? Please explain.

Response:

Sellers of residential real estate are never required to make any contribution to the ORG, nor will the ORG charge any fee of any sort whatsoever.

8. Please submit a copy of all forms sellers are required to complete: Response: See enclosed

9. Requested Information:

You have indicated that your organization will comply with Revenue Procedure 96-32 and you have submitted a declaration agreeing to comply with Revenue Procedure 96-32. Revenue Procedure 96-32 provides a safe harbor provision for organizations that develop or maintain housing projects to provide housing to low income individuals. Based on your organization's proposed activities it appears that the safe harbor provisions in Revenue Procedure 96-32 are not applicable to your organization. Your organization will provide financial assistance to individuals to purchase homes located at scattered sites in the community. Please explain in detail how the safe harbor provisions are applicable to your organization.

Response:

In my conversation with IRS exempt organizations specialist Agent (ID) on February 5, 20XX, Agent instructed me that all charitable organizations involved in any way with providing down payment assistance were required to sign an agreement evidencing their compliance with Revenue Procedure 96-32. She then faxed me a document entitled "Declaration of Compliance with Revenue Procedure 96-32". I have attached a copy of said facsimile. Neither I nor the ORG now make or have made any representation as to the applicability of Revenue Procedure 96-32 to the ORG's activities. The ORG has agreed to comply with all requirements of the Internal Revenue Code and applicable regulations and procedures, including those expressed by Agent on February 5, 20XX.

10. Requested Information:

    The flyer you submitted with your application for exemption states, "There are no income or asset limits and no geographical location restrictions as is a nationwide program. This program is designed to allow everyone the opportunity to own their own home." Please explain in detail how this program serves a charitable purpose under section 501(c)(3) of the Code.

    Response:

    The members of the board of directors of the ORG have determined that many individuals in need of assistance are reluctant to ask for assistance because they experience shame, embarrassment or guilt in asking for help. In addition, it appears as though many are embarrassed to admit they are "low income individuals". The ORG believes it will be able to generate greater interest, and help applicants minimize embarrassment and shame, by structuring it promotional material in this manner. By doing so, the ORG may provide solutions for and assistance to traditionally underserved individuals and their communities.

The original 1023 application provided by ORG. disclosed that the sources of financial support will come in the form of contributions from individuals, grants from various governmental agencies, and grants from other 501(c)(3) organizations. The application also stated that the ORG will raise money by soliciting contributions from community organizations and charitable organizations, individuals selling homes to participants in the ORG's homebuyer assistance program and conducting fundraising drives. The application also states that the ORG anticipates that many sellers may contribute to the ORG's charitable purposes, but no seller will be required to contribute in order for a participant to receive down payment assistance.

Articles of Incorporation:
Included in the Articles of Incorporation for the ORG dated October 29, 20XX, are the following:

> Article II: The corporation is organized pursuant to the XYZ Nonprofit Corporation Code(the "Code").

Article XIII: The Corporation is a nonprofit corporation and is organized exclusively for charitable purposes including (i) making distributions to organizations that are designated as charitable organizations under Section 501(c)(3) of the Internal Revenue Code of 1986 as amended, (ii) providing down payment assistance to individuals of low to moderate income levels, first time homebuyers, displaced spouses, single parents and such other persons in need of down payment assistance, (iii) providing education to first time homebuyers regarding home ownership and mortgage requirements, (iv) leasing, purchasing and selling any and all kinks of property in furtherance of the purposes of the Corporation and (v) carrying on any lawful business under the laws of the State of XYZ governing nonprofit corporations, subject to the limitations of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. The Corporation shall do all such things as are incidental and/or conducive to the attainment of its charitable objectives.

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

Federal Returns:

The ORG filed Form 990 for the period ended June 30, 20XX; the organization reported the income from the down payment from the seller as contributions.

Part III, of the ORG's Form 990 for the 20XX tax year state the exempt purpose of the organization as follows: "Assist home buyers with down payments in order to purchase personal residence."

In the period ending June 30, 20XX, the ORG received $ in gross revenue from amounts paid to it by sellers participating in the ORG's DPA program. The ORG reported the seller's payments as contributions. The ORG also reported that it distributed $ in down payment assistance to homebuyers for use as down payments and/or to pay for closing costs. The ORG's form 990, Part IV, line 73 shows that as of June 30, 20XX, the ORG had total unrestricted/net assets of negative $.

Operation of Down Payment Assistance Program:

The ORG advertised in its publication the process through which an applicant may receive down payment assistance.

The ORG's publication included the following information:

The ORG offers potential homebuyers a nationwide down payment assistance program that has helped many people to purchase a home. There are no income restrictions or first time buyer or educational requirements. The ORG will give the potential applicant up to 5% of the sale price of the house to be used as a down payment or for closing costs. The funds are a gift to the potential home buyer from a non-profit charitable organization. The funds are not required to be repaid. The seller makes a contribution to the ORG to cover the amount of the gift and a small additional service fee. The ORG works with mortgage lenders and realtors nationwide to offer the program. The mortgage lenders will help to determine if the potential home buyer is qualified for the program.

The ORG does not provide down payment assistance to the buyer if the seller does not enter into the agreement. If the seller agrees to participate, the agent and buyer must sign a "gift request." The "gift request" and the loan agreement then go to the underwriter for loan approval. If the loan is not approved, the seller will not make a "gift" to the organization. The ORG does not participate in the processing of the loans. Once the loan is approved, the amount agreed to by the seller on the "gift request" is disbursed to the ORG, which then provides the assistance to the buyer for the down payment during the closing.

The seller wires or delivers the "gift funds" to the closing attorney; the money is not given directly to the ORG by the seller). The check is made payable to the closing attorney and is deposited into an escrow account. After closing, the funds are wired to the ORG by the attorney. If the sale is not completed, the seller provides no funds to the ORG.

In the 20XX tax year, the ORG received 100 percent of its income from transactions in which there are agreements between a buyer and seller regarding specific properties owned by the sellers. The ORG does not provide "gift funds" to any buyer if the seller of the home does not agree to participate in the program.

The ORG does not have any income limitations for its DPA program. The records provided by the ORG did not include data on the buyers' incomes and gave no indication that the ORG screened applicants based on such data. The ORG's DPA program provided down payment assistance to any homebuyers who qualified for a loan if the sellers agreed to participate in the program. According to the flyer provided by the ORG, no conditions are placed on the buyer except that the buyer must be approved for a loan by a mortgage lender or broker. The flyer also stated that there are no underwriting guidelines and no income qualifications; no funds are delayed and processing is fast.

The Form 1023 stated that the ORG obtains funds by requesting contributions from the seller and by requesting contributions from various charitable organizations, government programs, and individuals. The return for the 20XX fiscal year ending June 30, 20XX, however, reflects that 100 percent of the revenue received is from the sellers of the homes.

<u>Law and Analysis:</u>

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

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 section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

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

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

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

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

In Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988), the U.S. Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under section 501(c)(3). The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman's child sponsored the care financially. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in § 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

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

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of § 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).

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

Revenue Ruling 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of section 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

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

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

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

Revenue Ruling 2006-27, 2006-21 C.B. 915, in part, discusses whether organizations that provide DPA in situations in which there is a direct correlation between the amount of the DPA provided by the organization and the amount of the seller's payment to the organization, operate exclusively for charitable purposes. The revenue ruling held that an organization does not qualify as an organization described in section 501(c)(3) if it relies for its financing on sellers and other real-estate related businesses that stand to benefit from the transactions the organization facilitates. Further, in deciding whether to provide assistance to an applicant, the organization's grantmaking 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 the organization. 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 the organization'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, the organization 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, the organization is structured and operated to assist private parties who are affiliated with its funders. Because the organization is not operated exclusively for exempt purposes, the organization does not qualify for exemption from federal income tax as an organization described in section 501(c)(3).

Benefiting Private Interests:

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

Revenue Ruling 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) because it gave preference to employees of a business operated by the individual who also controlled the organization. The ruling reasoned that, although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

In <u>KJ's Fund Raisers v. Commissioner</u>, T.C. Memo 1997-424 (1997), <u>aff'd</u>, 163 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of KJ's Place, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of KJ's Place. The organization derived most of its funds from its lottery ticket sales. The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations. Although supporting charitable organizations may be a charitable activity, the Tax Court nevertheless upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of KJ's activities was to benefit KJ's place and its owners by attracting new patrons, by way of lottery ticket sales, to KJ's Place, and by discouraging existing customers from abandoning KJ's Place in favor of other lounges where such tickets were available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

<u>Effective date of revocation:</u>

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 <u>et</u> <u>seq</u>.), 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:

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

Charitable purposes include relief of the poor and distressed. See Treas. Reg. § 1.501(c)(3)-1(d)(2). The ORG's down payment assistance program does not operate in a manner that establishes that its primary purpose is to address the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1. The down payment assistance program did not serve exclusively low-income persons. The ORG does not have any limitations for participation in its DPA program. The ORG did not screen applicants for down payment assistance based on income. The ORG's records do not include data on the buyers' incomes. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for loans.

The ORG's program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3) of the Code.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The ORG's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in the ORG's 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 homes at the homes' listed prices or by being able to reduce the amount of the negotiated discounts. Buyers who participate in the ORG's program benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals who participate in the ORG's program, from real estate brokers to escrow companies, benefit from increased sales volume. The ORG's program provides private benefit to the parties in each home sale.

The ORG's down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, the ORG relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates. The ORG neither solicits nor receives funds from other sources. Before providing down payment assistance, the ORG's staff takes into account whether there is a home seller willing to make a payment to cover the down payment assistance the applicant has requested. The ORG requires the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus an administrative fee of several hundred dollars per home sale. The ORG secures an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless the ORG is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing.

The ORG's promotional material and its marketing activities show that it's operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in section 501(c)(3). The manner in which the ORG operated its DPA program shows that the ORG was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect the ORG's operations were similar to an organization which was denied exemption because it operated a conference center for commercial purposes. <u>See</u> <u>Airlie ORG v. Commissioner</u>, 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 <u>Aid to Artisans, Inc. v. Commissioner</u>, 71 T.C. 202 (1978), the ORG's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. The ORG provided services to home sellers for which it charged a market rate fee. The ORG did not market its services primarily to persons within a charitable class. The ORG did not solicit or receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in <u>American Campaign Academy</u>, <u>supra</u>, and <u>Easter House</u>, <u>supra</u>, a substantial part of the ORG's activities furthered commercial rather than exempt purposes.

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

The government proposes revoking the ORG's exemption, effective the date of the organization's inception because the organization operated in a manner materially different from that represented in its application for exemption. In its Form 1023, the ORG represented that its purpose was to "assist those individuals, who have a poor credit history and are unable to obtain financing through conventional lenders and those individuals that have a reasonable credit history and are unable to save enough money for the down payment." According to the Form 1023, the ORG planned to develop several programs that it believed to be appropriate to accomplish the above objectives. These programs are the down payment assistance program, education and counseling, and community reinvestment. ORG provided information on the 1023 application pertaining to educating and counseling the public, through seminars and web sites (online seminars), regarding mortgages, personal finance, credit reporting, and predatory lending. The ORG did not provide documentation during the examination showing this education was provided.

The examining agent found that the only program operated by the ORG appeared to be the down payment assistance program financed by fees from the seller. There was no evidence of additional fund raising activities or the operation of additional activities. 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. Since the ORG operated its activities in a manner materially different from that represented in its application for exemption retroactive revocation is appropriate.

ORG's Position:

The ORG's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. The ORG will be allowed 30 days to review this report and respond with a rebuttal if considered necessary.

Conclusion:

The ORG is not operated exclusively for exempt purposes as an organization described in Internal Revenue Code section 501(c)(3); further it is operated in a materially different manner than that described in its Form 1023. Revocation of exempt status is proposed, effective the date of the organization's inception.