



**DEPARTMENT OF THE TREASURY**

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

501.03-00

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

March 20, 2000

Number: **201418055**  
Release Date: 5/2/2014

Person to Contact:  
Identification Number:  
Contact Telephone Number:  
In Reply Refer to: TE/GE Review Staff  
EIN:

ORG  
ADDRESS

**CERTIFIED MAIL – Return Receipt Requested**

**LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT:**

June 24, 20XX

Dear :

This is a final revocation letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. The Internal Revenue Service's recognition of your organization as an organization described in section 501(c)(3) is hereby revoked effective January 1, 20XX.

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 interest of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purpose described in section 501(c)(3).

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

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for 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 91<sup>st</sup> 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 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling, 404-338-8099, or write:

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,

Douglas H. Shulman  
Commissioner  
By

Sunita Lough  
Director, EO Examinations

Enclosures:

Publication 892  
Publication 1546  
Notice 437

cc:

Internal Revenue Service

Department of the Treasury  
TE/GE Exempt Organizations Examinations  
915 Second Avenue M/S W540  
Seattle, Washington 98174

Date: **July 29, 2008**

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact UID Number:

Contact Numbers:

Telephone:

Fax:

**Certified Mail - Return Receipt Requested**

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

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

**LEGEND**

ORG - Organization name      XX - Date      EIN - EIN      Address -  
address      City - city      State - state      County - county  
website - website      POA & POA-1 - 1<sup>st</sup> & 2<sup>nd</sup> POA      BM-1 through  
BM-6 - 1<sup>st</sup> through 6<sup>th</sup> BM      DIR-1 through DIR-4 - 1<sup>st</sup> through 4<sup>th</sup>  
DIR      CO-1, CO-2 & CO-3 - 1<sup>st</sup>, 2<sup>nd</sup> & 3<sup>rd</sup> COMPANIES

Whether ORG's exempt status under Internal Revenue Code Section 501(c)(3) should be revoked because:

1. ORG has not submitted additional information as required under IRC Section 6001 for purposes of inquiring into the organization's exempt status.
2. ORG has more than an insubstantial part of its activities furthering non exempt purposes.
3. ORG has not established that it operates to serve public interests, but rather serves the private interests of real estate professionals.

**Facts:**

ORG is a not-for-profit corporation formed under the laws of the State of State effective on November 9, 20XX. DIR-1 is the organization's registered agent. ORG's address is Address, City, State. The incorporators of the organization are DIR-1, DIR-3, and DIR-2. The stated purposes of the organization as described in its Articles of Incorporation are to:

- (1) act and operate exclusively as a non-profit corporation pursuant to the laws of the State of State;
- (2) act and operate exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code;
- (3) not be organized and operated for profit or the private gain of any individual or entity; and
- (4) no substantial part of the activities of the corporation shall be the carrying on of propaganda, or attempting to influence legislation, and the Corporation shall not participate in, or intervene in (including the publishing or distribution of statements) a political campaign on behalf of or in opposition to any candidate for public office.

Article IV(a) states that the property of the corporation is irrevocably dedicated to charitable, educational, and public purposes and no part of the net income or assets of the corporation shall ever inure to the benefit of any trustee, officer, or member thereof, or to the benefit of any private persons. Article IV(b) states that upon the dissolution of the corporation, its assets remaining after payment of or provision for payment of all debts and liabilities of the corporation shall be distributed for one or more exempt purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code.

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Article VI states that the corporation shall be governed by a Board of Trustees. The number, qualifications, and elections of the trustees will be governed by the bylaws of the corporation. The members of the current Board of Trustees, who shall hold office until their successors shall have been duly elected and assume office pursuant to the Bylaws. are DIR-1, DIR-3, and DIR-2.

Article VII(a) states that no trustee, officer, managing agent, employee, or other person will derive a principal economic benefit from the operation of the corporation. However, any person, including an officer or trustee of the corporation, may enter into a contract with the corporation, provided that no person or entity shall be paid any fee, salary, rent, or other payment of any kind in excess of the fair market value for the service rendered, goods furnished, facilities or equipment rented; provided further, that at a meeting of the trustees or a committee having authority in the premises to authorize or confirm such contract or transaction, it will be approved by the majority of trustees or committee members. Article VII(b) states that no member of the Board of Trustees will be liable to account to the Corporation for any transaction or contract of the corporation ratified or approved, and they are relieved from any liability that might otherwise exist with respect to such transaction or contract, provided that they act in good faith.

The stated purposes of the organization as described in its Bylaws are to provide down payment assistance for qualified purchasers of real property, and to enable it to function as a State non-profit corporation duly qualified as an educational and charitable organization within the meaning of Sections 501(c)(3) and 170(c) of the Internal Revenue Code. Article IV(A) of the bylaws states that the business and affairs of the corporation will be managed by its Board of Directors. Section IV(B) states that the initial Board of Directors will consist of three persons. The initial Board of Directors of ORG only consisted of the following two individuals:

Name:	Address:
DIR-1	Address, City, State
DIR-4	Address, City, State

#### Application for Recognition of Tax-Exempt Status

On October 31, 20XX, the Internal Revenue Service received ORG's Form 1023, "Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code". The Internal Revenue Service requested additional information regarding ORG's activities to complete the process of determination of exempt status. The Internal Revenue Service's administrative files retained copies of ORG's Form 1023 and requested attachments, as well as IRS correspondence and the organizations response. ORG's application stated that the organization was formed to provide mortgage assistance to prospective homeowners who lack the resources for a down payment. The down payment assistance support is open to all applicants regardless of race, religion, or economic criteria.

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During the initial review of the organization's Form 1023, the Internal Revenue Service requested ORG to expand its Board of Directors to include individuals from the community where the organization was operating. On October 31, 20XX, the resignation of the original members of the Board of Directors of ORG was accepted. The new Board of Directors consists of BM-1, BM-2, and BM-3. ORG stated that BM-4, BM-5, and BM-6 would not be salaried and were not related to DIR-1.

A resolution was made by the Board of Directors stating that the majority of the Board of Directors would be non-salaried and would not be related to salaried personnel or to parties providing services. In addition, the salaried individuals could not vote on their own compensation and that all compensation decisions would be made by the Board of Directors. ORG stated prior to obtaining tax exempt status that DIR-1 would be an officer of the organization and appointed as President of ORG. As President, DIR-1 would administer the organization's programs by providing down payment mortgage assistance to qualified individuals. In the original application for exemption, ORG stated that it does not have a definitive relationship with any for profit mortgage companies or similar entities.

The organization provided written descriptions of the backgrounds of each of the members of the Board of Directors. The organization stated that BM-4 operated an automobile business for 35 years. It stated that he was currently retired but remained active in the business community. BM-5 owned and operated a vending machine business for 46 years. He was currently retired but remained active in the business community. The application also stated that BM-6 spent 40 years in the veterinary supply business. He was also retired but remained active in certain business ventures. The State Real Estate License Verification System's website <http://realestate.State.gov> was researched to determine whether any of the members of the Board of Directors or the President of ORG, DIR-1, held any professional licenses related to engaging in the business of mortgage lending, or acting in the capacity as a real estate agent. No professional licenses were identified for BM-4 or BM-5. The professional licenses identified for DIR-1 and BM-5 is shown in Exhibit 1.

Exhibit 1:

### TABLE DELETED

ORG stated in an attachment to Form 1023 that it would operate in a manner similar to the 501(c)(3) organizations described in Revenue Ruling 70-585, 170-2 C.B. 115, by providing assistance in obtaining housing for low and moderate income families. ORG stated that it was formed for the purpose of providing down payment assistance for affordable housing to economically disadvantaged persons. The application stated that ORG would review income criteria but would not review any other demographic, racial, or sociological data. ORG stated that the applicants for the down payment assistance support principally require help because

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they lack capital rather than lack income. The 1023 stated that if the applicants lack sufficient income, they generally will not qualify for the principal mortgage. ORG stated that the individuals identifying qualified recipients of down payment assistance will be members of the mortgage industry.

ORG stated that there was little potential of misuse of the grant funds because the down payment assistance support would be made directly to the title company and become part of the purchase transaction for each respective home. ORG stated that if any misuse of the funds was identified, the organization intended to actively pursue the recovery of the funds. ORG stated that the sellers of the homes are entitled to participate in the down payment assistance program, but are not required to donate a percentage of the selling price of the home to ORG. The organization stated that the sellers of the homes, as beneficiaries in the down payment assistance program, have no personal or business relationship with any members of the Board of Directors of ORG.

ORG stated that it would conduct its down payment assistance activities principally in the United States with an initial focus in State. The Form 1023 indicated that the principal applicants were expected to be those who qualify for assistance because they lack the financial resources necessary to make the required down payment, or who need assistance to qualify for financing for the purchase of a home. The prospective applicants did not have to pay for the down payment assistance received. The fee that ORG charged for its services was paid by the home seller. ORG stated that its initial source of capital would be received from several large contributors. The organization stated that it anticipated additional funds would be received from borrowers who had already received mortgage down payment assistance, or individuals who appreciated the need for mortgage down payment assistance.

ORG stated that it would have an office located at Address, located in City, State from which it would conduct its down payment assistance management program. The organization stated that the office facility would not be used by any other entity other than ORG, and that none of the directors or employees of ORG would reside at the facility. The County Assessor's website was reviewed at <http://www. .org> to identify ORGs facility. Records show that DIR-1 is the owner of the property located at Address in City, State. Internal Revenue Service records also show this location to be DIR-1s address of record. A picture of the facility in question is reproduced below in Exhibit 2:

Exhibit 2: Address:

Address

City, State

Parcel Number:

Property Type: Single Family Residence

PICTURE DELETED



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ORG indicated that the organizations' sources of financial support would be from charitable contributions received by the organization. Additional capital might come in the form of contributions from other unrelated mortgagors and borrowers. The organization indicated in Part III of Form 1023 that the initial capital into the organization would be received from several large donors.

On March 6, 20XX, the Internal Revenue Service issued a determination letter recognizing ORG as a tax-exempt organization described in Section 501(c)(3) of the Internal Revenue Code. The Service's determination letter also determined that the organization would initially be considered, pursuant to an advance ruling period, as an organization which is not a private foundation under Sections 509(a)(1) and 170(b)(1)(A)(vi) because the organization could reasonably expect to attract enough public support to meet the public support tests.

The determination was based on the assumption that ORG would operate in the manner represented in its application, Form 1023, and attachments. The letter stated that the ruling was based on the understanding that the majority of the Board of Directors will be non-salaried, and would not be related to salaried personnel or to parties providing services. It was also based on the understanding that salaried individuals would not vote on their own compensation and that compensation decisions would be made by the Board of Directors. The letter also stated that if the organization distributed funds to individuals, the organization should keep case histories showing the recipients names, addresses, purposes of awards, manner of selection, and relationship (if any) to members, officers, trustees, or donors to the organization, so that ORG could substantiate any and all distributions that the organization made to individuals upon request by the Internal Revenue Service.

#### Federal Returns

For the year under examination, the organization's Form 990 reported direct public support of \$ and interest income of \$. The total assets were listed as \$. ORG reported expenses of \$ for specific assistance to individuals, \$ of finance fees, and \$ for financial service costs. The financial service costs and fees were paid to a for-profit mortgage lending company named CO-1. CO-1 is a limited liability company formed under the laws of the State of State effective February 22, 20XX. DIR-1 is the company's registered agent. All of ORG's expenses listed on the 20XX Form 990 are identified as being incurred from conducting the down payment assistance activities. Per the schedule attached to the 20XX Form 990 and the settlement statements provided by the organization, ORG completed 141 down payment assistance transactions. The organization received % of its income from individual home sellers, % from real estate companies, and % of the income was not specifically identifiable. An analysis of the organization's transactions during the year under examination is detailed below:

TABLE DELETED

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Requests to ORG to describe its activities

On April 21, 20XX, ORG was issued Letter 3606 with an Information Document Request from the Internal Revenue Service Exempt Organization Compliance Unit located in City, State. The letter stated that the organization's 20XX Form 990 was selected for examination. The organization did not initially file the 20XX Form 990. The letter requested the organization to respond in writing to provide a detailed description of its activities by May 22, 20XX.

On August 9, 20XX, the organization's President, DIR-1, was contacted by phone. DIR-1 stated that he received Letter 3606 sent by the Exempt Organization Compliance Unit mailed on April 21, 20XX. DIR-1 stated that he provided the letter to his accountant to provide the requested information. DIR-1 stated that the organization is not currently operating and will not operate in the future.

On September 12, 20XX, DIR-1 was contacted by phone. DIR-1 was advised that no response has been received from the letter sent to him on April 21, 20XX by the Exempt Organization Compliance Unit. DIR-1 stated that he would contact his accountant again to provide the requested information. DIR-1 stated that the organization has been administratively dissolved through the State of State.

On October 18, 20XX, DIR-1 was contacted directly by phone. DIR-1 stated that his accountant would provide a copy of the Articles of Dissolution filed with the State of State. On October 30, 20XX, DIR-1 was contacted directly by phone. DIR-1 was requested to provide a copy of the Articles of Dissolution filed with the State of State to demonstrate that the organization has been properly dissolved.

On November 8, 20XX, an unsuccessful attempt was made to contact DIR-1 directly by phone. On November 9, 20XX, Letter 3606 with an Information Document Request was prepared and sent to the organization by certified mail. DIR-1 was requested to provide a copy of the Articles of Dissolution filed with the State of State, a resolution signed by two officers indicating the date of dissolution, and a document from the State of State acknowledging the dissolution. DIR-1 was also requested to provide a signed statement from an officer advising of the disposition of the organization's assets, and the name of the Internal Revenue Code Section 501(c)(3) organization that the assets were distributed to. The organization was also requested to provide a final tax return. The letter requested the organization to respond in writing by providing a detailed description of its activities by December 9, 20XX. On November 30, 20XX, a faxed copy of the Articles of Dissolution filed with the State of State was received from DIR-1.

On December 5, 20XX, the certified letter sent to DIR-1 on November 9, 20XX was received back from the post office unclaimed. On December 7, 20XX, an unsuccessful attempt was made

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to contact DIR-1 directly by phone. On December 12, 20XX, DIR-1 was contacted directly by phone. DIR-1 was advised that the letter sent to him on November 9, 20XX was returned from the post office because it was unclaimed. Letter 3606 with the Information Document Request previously sent to DIR-1 on November 9, 20XX by certified mail was faxed to him.

On January 3, 20XX, a faxed copy of Form 2848, Power of Attorney and Declaration of Representative, was received from POA. On January 4, 20XX, POA was contacted directly by phone. POA requested to be faxed Letter 3606 with the Information Document Request that was originally mailed to DIR-1 on November 9, 20XX and faxed to DIR-1 again on December 12, 20XX. POA stated that the organization engaged in down payment assistance activities during tax year 20XX. POA was requested to file the delinquent 20XX Form 990. On January 25, 20XX, POA was contacted directly by phone. POA stated that he was reviewing the information provided to him by DIR-1. On January 31, 20XX, an incomplete 20XX Form 990 was received by fax from POA.

On February 15, 20XX, an unsuccessful attempt was made to contact POA and DIR-1 by phone. On February 16, 20XX, an unsuccessful attempt was made to contact DIR-1 by phone. POA was contacted directly by phone. POA was advised that the 20XX Form 990 was incomplete. POA requested the original letter that was sent to DIR-1 on April 21, 20XX by the Exempt Organization's Compliance Unit located in City, State be resent to him. POA stated that the organization began operations in January 20XX and ended operations in November 20XX. A copy of Letter 3606 with an Information Document Request originally sent to ORG on April 21, 20XX was sent to DIR-1 and POA by certified mail. Letter 3606 with the Information Document Request was also faxed to POA.

On March 19, 20XX, a copy of a report prepared by the United States Government Accountability Office and presented to the Chairman of the Subcommittee on Housing and Community Opportunity, and the Chairman of the Committee on Financial Services of the United States House of Representatives was mailed to DIR-1 and POA. The report is entitled "Mortgage Financing -Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products".

On April 3, 20XX, a copy of a report prepared by the United States Government Accountability Office and presented to the Chairman of the Subcommittee on Housing and Community Opportunity, and the Chairman of the Committee on Financial Services of the United States House of Representatives was mailed to DIR-1 and POA. The report is entitled "Mortgage Financing- Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance. On April 16, 20XX, POA was contacted directly by phone. POA requested an extension to May 4, 20XX to provide the requested information.

On May 4, 20XX, a complete 20XX Form 990 was received by fax from POA. On May 29, 20XX, POA was contacted directly by phone. POA was requested to obtain a signed statement

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from DIR-1 advising of the disposition of the organization's assets, and the name of the Internal Revenue Code Section 501(c)(3) organization that the assets were distributed to. On May 30, 20XX, an unsuccessful attempt was made to contact POA by phone.

On June 1, 20XX, POA was contacted by phone. POA was requested to file a final 20XX Form 990 for the organization. On June 15, 20XX, the original signed 20XX and 20XX Forms 990 were received from POA. The primary exempt purpose of ORG as described by DIR-1 in the 20XX Form 990 is "to assist the underprivileged with the down payment to qualify for a loan to purchase a residence".

On September 14, 20XX, an unsuccessful attempt was made to contact DIR-1 by phone. POA was contacted directly by phone. POA was advised that the relevant parts of ORG's determination file, and other pertinent documents obtained by the Internal Revenue Service will be provided to the organization. ORG was requested to respond by October 15, 20XX whether the information presented accurately reflects the activities of the organization.

The first set of documents contained information obtained from the State Department of Commerce Business Entity Search website for ORG and CO-1. The second set of documents contained information obtained from the State Division of Real Estate License Verification System website for DIR-1 and BM-3. The third set of documents contained information obtained from the County Assessor's website describing the property located at Address in City, State. The fourth set of documents contained copies of the Internal Revenue Service's determination file, which included copies of ORG's Form 1023 and requested attachments, as well as IRS correspondence and the organization's responses. On September 24, 20XX, DIR-1 was contacted by phone and requested to review the information provided on September 14, 20XX, and provide a written response.

On October 15, 20XX, a phone call was received from POA-1 who stated that he was appointed Power of Attorney of ORG. POA-1 was requested to fax Form 2848 "Power of Attorney and Declaration of Representative" for verification of his authority to represent the organization.

On November 2, 20XX, a faxed copy of Form 2848 was received from POA-1. The power of attorney authorization of POA was revoked with the filing of the subsequent Form 2848.

On December 6, 20XX, POA-1 provided a written response to the letter sent to DIR-1 on September 14, 20XX. POA-1 stated that ORG was formed for the purpose of providing down payment assistance for affordable housing for economically disadvantaged persons as qualified purchasers of real property. POA-1 stated that the applicants for the home mortgages. Who did not have the required down payment, may apply for down payment assistance under the Department of Housing and Urban Development's guidelines. The principal activity of ORG is to provide support to recipients who qualify for down payment assistance regardless of race, religion, or economic criteria. He stated that the initial capital for the organization came from

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charitable contributions. He stated that the activities conducted by the organization were principally in State and were conducted on a year round basis. POA-1 stated that voluntary contributions by sellers of real property were aggregated by the organization to provide down payment assistance to qualified individuals.

POA-1 stated that ORG did not regularly correspond with the contributors or funding recipients. He stated that the HUD-1 closing statements acknowledge the charitable contributions by various sellers to enable the down payment assistance. POA-1 stated that ORG did not enter into any contracts with other organizations or individuals, and did not enter into any agreements with other companies to market its down payment assistance program. He stated that given the simplicity of the organization's business, it did not make or retain any workpapers or schedules to reconcile its books. POA-1 stated that ORG has no directly affiliated or related entity. He stated that the principal of ORG, DIR-1, is also principally involved in a mortgage lending company named CO-2 POA-1 stated that ORG never opened a checking account, does not have a check register, and only transferred funds by wire transfer.

POA-1 provided a sample of CO-3's seller participation letter and down payment assistance closing statement. DIR-1 is the Registered Agent of CO-3• a for profit corporation. The address of CO-3 is Address located in City, State. POA-1 stated that the seller participation letter is to receive funding from qualified contributors. He stated that the seller participation letter and the down payment assistance closing statement are the two primary documents used by the organization, and the loan agreement is typical of the agreements used in each transaction. POA-1 stated that no other contract with 1 prospective purchasers of real estate was executed. POA-1 stated that the two transactions are independent of one another. The seller participation letter stated:

The seller desires to sell his or her property at the location indicated. It is agreed that CO-3 will arrange for the gift funds, from a non-profit charitable organization, for some, or all of the down payment and/or closing costs for the buyer of the stated property. The seller agrees to give a donation to ORG, a 501(c)(3) non-profit organization, a percentage of the contract sales price. It is also agreed that an approved closing and/or title company will provide closing and escrow services. The donation will be wired to ORG no later than 12:00 pm MST on the next business day after the recording of the sale of the property. If for any reason the transaction does not close and record, the seller will have no obligation to give a donation to ORG.

In the event that the property does not close and record within forty-eight hours after the gift funds are received by the escrow company and/or the closing agent, the seller instructs and authorizes the escrow and/or closing agent to return the gift funds to ORG with no further signatures required. The donation made by the seller may not be tax deductible. It is recommended the seller seek independent tax advice on this matter.

The down payment assistance closing statement stated:

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The undersigned buyer has completed the necessary requirements to qualify for down payment and/or closing cost assistance. The buyer understands that his or her ability to receive down payment and/or closing cost assistance from ORG is subject to the availability of funds, and said funds are a gift for the purchase of property and ORG is not obligated to provide the funds to the buyer.

The undersigned buyer instructs the closing agent or escrow office to apply ORG's gift funds toward the purchase of the property. In the event the escrow is terminated, the buyer is unsuccessful in obtaining a loan, or the loan does not fund within forty-eight hours after the gift funds are received by the closing office, the buyer instructs and authorizes the closing office to return the gift funds to ORG without further instruction or signatures.

The buyer understands that the funds provided by ORG are a gift to assist the buyer in purchasing the real property, and the buyer is under no obligation to repay the funds either in the form of cash or services. The funds made available on the buyer's behalf will come from an existing pool of funds in an account owned and operated by ORG, a charitable non- profit 501(c)(3) organization, and are not being made available by any person or entity with an interest in the sale of the property. ORG has no relationship with the buyer or seller. Upon receipt of a signed copy of the gift letter, a signed HUD-1 statement, and wiring instructions, ORG will wire gift funds to the closing agent or escrow officer, in an amount which is equal to a percentage of the contract sales price.

ORG does not have any income or first time homebuyer limitations for its down payment assistance programs, and did not screen applicants for the down payment assistance it provided based on income. ORG does not provide financial counseling seminars or other educational programs to help prepare the potential home buyers for the responsibility of home ownership. Also, the organization does not require a home inspection as a condition of providing assistance to ensure that the house that the applicant intends to buy is habitable. ORG's down payment assistance program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions.

Law:

Internal Revenue Code

Section 501 of the Internal Revenue 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.

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Section 6001 of the Internal Revenue Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title.

Section 6033(a)(1) of the Code provides, except as provided in Section 6033(a)(2), every organization exempt from tax under Section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

#### Federal Tax Regulations

Section 1.501(a)-1(a)(2) of the regulations states that an organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. However, the Commissioner may revoke a favorable determination letter for good cause.

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

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

Section 501(c)(3)-1(d)(3)(i) of the regulations 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.

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) if

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the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business.

Treasury Regulation Section 1.6001-1(a) in conjunction with Treasury Regulation Section 1.6001-1(c), provides that every organization exempt from tax under Internal Revenue Code Section 501(a) and subject to the tax imposed by Internal Revenue Code Section 511 on its unrelated business income, must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by Section 6033 of the Internal Revenue Code.

Treasury Regulation Section 1.6001-1(e) states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

In accordance with the above cited provisions of the Code and Regulations under Sections 6001 and 6003, organizations recognized as exempt from federal income tax must meet certain reporting requirements. These requirements relate to the filing of a complete and accurate annual information (and 1 other required federal tax forms) and the retention of records sufficient to determine whether such entity is operated for the purposes for which it was granted tax exempt status and to determine its liability for any unrelated business income tax.

#### Court Cases

In the case of *Better Business Bureau of Washington, D.C., Inc., v. United States*, 326 U.S. 279, 66 S. Ct. 112, the Supreme Court considered whether the organization is exempt from social security taxes as a corporation organized and operated exclusively for scientific or educational purposes. The organization argued that all of its purposes and activities are directed toward the education of business professionals and the general public.

The Supreme Court held that in order to fall within the claimed exemption, the organization must be devoted exclusively to educational purposes. The Court stated that the presence of a single non- educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of the organization's truly educational purposes. The Court held that the organization's efforts to eliminate dishonest business practices primarily served to promote its own business community. The Court held that the organization's activities may have incidentally served to educate certain persons, but were not fundamentally directed towards furthering education.



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In *Easter House v. United States*, 12 Cl. Ct. 476, the United States 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.

The court found that the health related services were merely incidental 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 of plaintiffs adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in Section 501(c)(3) of the Internal Revenue Code.

In *American Campaign Academy v. Commissioner of Internal Revenue*, 92 T.C. No. 66, 92 T.C. 1053, 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.

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 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".

In *Aid to Artisans. Inc v. Commissioner of Internal Revenue*, 71 T.C. 202, the Court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Code. The organization, in cooperation with national craft

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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. The artisans constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the Court held that the organization operated exclusively for exempt purposes described in Section 501(c)(3) of the Code.

In *Living Faith, Inc. v. Commissioner of Internal Revenue*, 950 F.2d 365, the Court held that a religious organization which operated 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 Rulings

Revenue Ruling 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of Section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

Revenue Ruling 67-138, 196\_7-1 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. The organization carried on several activities directed to assisting low-income families obtain improved housing, including conducting a training course on various aspects of homebuilding and homeownership, coordinating and supervising joint construction projects, purchasing building sites for resale at cost, and lending aid in obtaining home construction loans.

Revenue Ruling 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and analyzed whether each organization qualified as a charitable organization within the meaning of Section 501(c)(3) of the Code. Situation 1 described an organization formed to

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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.

Situation 2 described an organization formed to improve 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) of the Code.

Situation 3 described an organization created 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) of the Code because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to reduce 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) because the organization's program was not designed to provide relief to the poor or further any other charitable purposes within the meaning of Section 501(c)(3) of the Code and the Regulations.

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.

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Revenue Ruling 20XX-27, I.R.S. 20XX-21, May 4, 20XX, discussed three situations of organizations providing down payment assistance and whether each qualified as a charitable organization within the meaning of Section 501(c)(3) of the Code. Situation 1 described an organization whose purpose and activities relieved the poor and distressed and underprivileged by enabling low-income individuals and families to obtain decent, safe, and sanitary homes. The way the organization conducted its down payment assistance program established that the organization's primary purpose was to address the needs of its low-income grantees. As a condition of providing assistance, the organization requires a home inspection to ensure that the house will be habitable. The organization conducts financial counseling seminars and other educational programs to help prepare potential home buyers for the responsibility of home ownership. The organization conducts a broad based fundraising program and receives support from a large number of sources.

The organization ensures that its grant making staff does not know the identity or contributor status of the party selling the home to the grant applicant (or any other party who may receive a financial benefit from the sale). The organization does not accept contributions contingent on the sale of any particular properties, ensuring that it is not obligated to any particular donors or other supporters whose interest may have conflicted with that of the low-income buyers. The organization's grant making procedures combined with its efforts to educate home buyers ensured that the organization was operated primarily to benefit the low-income beneficiaries of its down payment assistance. The low-income beneficiaries constitute a charitable class. Any benefit to other parties (such as home sellers, real estate agents, or developers) who participate in the transactions does not detract from the charitable purpose of relieving the poor and distressed. The revenue ruling held that because the organization was operated exclusively for charitable purposes it qualified for exemption as an organization described in Section 501(c)(3) of the Code.

Situation 2 describes an organization that was formed to finance its down payment assistance activities and relied on sellers and other real estate related businesses that stood to benefit from the transactions it facilitated. Furthermore, in deciding whether to provide assistance to a low income applicant, the organization's grant making staff knew the identity of the home seller and may have also known the identities of other interested parties and was able to take into account whether the home seller or another interested party was willing to make a payment to the exempt 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 indicated that the benefit to the home seller is a critical aspect of the organization's operations. This organization operates in a manner similar to *Easter House v. United States*, 12 Cl. Ct. 476, which received all of its support from fees charged to

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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 v. Commissioner of Internal Revenue*, 92 T.C. No. 66, 92 T.C. 1053, this organization was structured and operated to assist private parties who are affiliated with its founders. Like the organizations considered in *American Campaign Academy* and *Easter House*, this organization also served an exempt purpose, but because it is not operated exclusively for exempt purposes, the revenue ruling held that the organization does not qualify for exemption from federal income tax as an organization described in Section 501(c)(3) of the Code.

Situation 3 described an organization formed to combat community deterioration in an economically depressed area that has suffered a major loss of population and jobs. Studies have shown that the average income in the area is below the median level for the State. The organization cooperates with government agencies and community groups to develop an overall plan to attract new businesses to the area, and to provide stable sources of decent, safe, and sanitary housing for the area residents without relocating them outside the area. As part of the renewal project, the organization receives funding from government agencies to build affordable housing units for sale to low and moderate income families.

As a substantial part of its activities, the organization makes down payment assistance available to eligible home buyers who wish to purchase the newly constructed units from the organization. The organization also offers financial counseling seminars and conducts other educational activities to help prepare potential low and moderate income home buyers for the responsibility of home ownership. To fund its down payment assistance program and other activities, the organization conducts a broad based fundraising program that attracts gifts, grants, and contributions from several foundations, businesses, and the general public. The revenue ruling held that the organization's down payment assistance program serves a charitable purpose described in Section 501(c)(3) of the Code because it combats community deterioration in a specific, economically depressed area that has suffered a major loss of population and jobs.

In order to qualify for exemption under Internal Revenue Code Section 501(c)(3), an organization must be both 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. ORG does not qualify as an organization described in Internal Revenue Code Section 501(c)(3) because it operates a program that does not exclusively serve an exempt purpose described in Section 501(c)(3), and it provides substantial private benefit to persons who do not belong to a charitable class. Additionally, ORG failed to meet the reporting requirements under Sections 6001 and 6033 to be recognized as exempt from Federal income tax.

Based upon the information collected during the examination of the organization's 20XX Form 990, it appears that ORG is operating a seller funded down payment assistance program as

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described in situation 2 of Revenue Ruling 2006-27. The manner in which ORG operates its down payment assistance program demonstrates that the private benefit provided to the various participants in the program was the intended outcome of the organization's operations, rather than a mere incident of such operations.

To finance its down payment assistance activities, ORG relies exclusively on home sellers and other real estate related businesses that stand to benefit from the transactions it facilitates. ORG neither solicits nor receives funds from other sources. Before providing down payment assistance, ORG's grant making staff takes into account whether there is a home seller willing to make a payment to the organization to cover the down payment assistance that the applicant has requested.

ORG requires the home seller to reimburse it, dollar-for dollar, for the amount of the funds expended to provide down payment assistance on the seller's home, plus the payment of financial service costs to CO-1, a related for-profit entity controlled by ORG's President, DIR-1. The down payment assistance provided to the home buyer by ORG will not take place unless the organization is assured that the amount of the down payment plus the financial services costs paid to CO-1, is paid by the home seller upon closing.

ORG's receipt of a payment from the home seller which corresponds to the amount of the down payment assistance demonstrates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of ORG's operations. In this respect, ORG is operated in a manner similar to the organization considered in *Easter House v. United States*, 12 Cl. Ct. 476, which provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially.

ORG provides down payment assistance in the form of grants to any homebuyer who qualifies for a loan for the purchase of a home. The organization does not have any income or first time homebuyer limitations for its down payment assistance programs, and did not screen applicants for the down payment assistance it provided based on income. ORG does not provide financial counseling seminars or other educational programs to help prepare the potential home buyers for the responsibility of home ownership. Also, the organization does not require a home inspection as a condition of providing assistance to ensure that the house that the applicant intends to buy is habitable.

ORG's down payment assistance program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes with no 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.

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ORG has not demonstrated that it conducts a broad based fundraising program, or that it receives support from a large number of sources. The organization does not have a policy of ensuring that its grant-making staff does not know the identity or contributor status of the party selling the home to the grant applicant (or any other party who may receive a financial benefit from the sale). ORG has not demonstrated that it does not accept contributions contingent on the sale of any particular properties, to ensure that the organization is not obligated to any particular donors or other supporters whose interest may conflict with that of the low income buyer.

Section 1.501(c)(3)-1(d)(2) of the regulations states that charitable purposes include the relief of the poor and distressed. ORG applied for exemption from tax for the purpose of assisting the underprivileged with the down payment to qualify for a loan to purchase a residence. 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, and safe housing. ORG's down payment assistance program does not serve exclusively low income persons.

Despite ORG's representations that its down payment assistance program is designed for assisting the underprivileged with the down payment to qualify for a loan to purchase a residence, ORG does not have any income limitations for participation in its program. ORG did not screen applicants for down payment assistance based on income. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. Based on multiple sales to real estate professionals, the program is not even limited to first time homebuyers.

ORG's down payment assistance program is designed to channel funds in a circular manner from the home seller to the home buyer. First, the home seller makes a donation to ORG. During the year under examination, ORG received 118 separate donations from individual home sellers and real estate companies. The average donation received was \$. By making a contribution to an organization recognized as exempt under Section 501(c)(3) of the Internal Revenue Code, the contributor would be eligible to take a charitable contribution deduction for the amount of the donation. ORG reported the contributions received as direct public support.

In 20XX, ORG received total contributions of \$. ORG paid \$ in financial service costs to CO-1, which is a for-profit mortgage lending company controlled by ORG's President, DIR-1. After payment of the fees to facilitate the transaction between the home seller and home buyer, ORG provides grants to the buyer to purchase the seller's home. During the year under examination, ORG paid \$ in grants for the buyers to use as a down payment on the seller's home. The actual funds being used by the buyer to purchase the seller's home was originally provided by the seller whose home is being purchased. The only purpose of this transaction is to benefit the parties who have a direct financial interest in each of the transactions.

An illustration of ORG's down payment assistance program is detailed below:

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**Buyer B**

- ORG issues a grant to the home buyer to purchase the seller's home.
- In 20XX, \$ in down payment assistance grants were provided to the buyer by ORG.
- The buyer uses the down payment assistance grant provided by the home seller as a down payment to purchase the seller's home.

**Seller A**

- The home seller makes a donation to ORG.
- In 20XX, \$ was donated by home sellers to ORG.
- The home seller is entitled to a charitable contribution deduction for donating funds to an organization exempt under Section 501(c)(3) of the Internal Revenue Code.

**CO-1**

- In 20XX, ORG paid CO-1 \$ in finance fees.
- In 20XX, ORG paid CO-1 \$ in financial service costs.
- DIR-1 is the registered agent of CO-1.
- DIR-1 financially benefits from each transaction.
- CO-1 becomes the mortgage lender in these transactions.

**ORG**

- The funds received from the home seller to ORG are recorded as contributions.
- In 20XX, \$ was received.
- Contributions received by ORG are exempt from tax.
- President DIR-1 exercises complete control over the activities of ORG. No other officers or employees were listed as being involved with any of the operations of ORG on the organization's 20XX Form 990.

ORG operates its down payment assistance program in a manner indistinguishable from a commercial enterprise. The organization's primary activity is brokering transactions to facilitate the selling of homes. ORG's primary goal is to maximize the fees from these transactions to benefit its President, DIR-1, and his for-profit entity, CO-1. ORG's brokering services are marketed to home-buyers, home-sellers, realtors, lenders, home builders, and title companies regardless of the buyers' income level or need, and regardless of the condition of the community in which the home is located. Alliances are built with realtors, lenders, home builders, and title companies to assure future business for the mutual benefit of the participants. The manner of operating a trade or business of facilitating home sales is not an inherently charitable activity. The organization does not engage in any counseling or other activities that further charitable purposes.

As illustrated in *American Campaign Academy v. Commissioner of Internal Revenue*, 92 T.C. No. 66, 92 T.C. 1053, ORG's down payment assistance program is structured and operated to



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assist the private parties who fund it and give it business. The parties who benefited by the down payment program include realtors, builders, and lenders who benefited more than incidentally from ORG's down payment assistance activities. Sellers who participate in the organization's down payment assistance program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time their home is on the market. They also benefit by being able to sell their home at the home's full listed price or by being able to reduce the amount of the negotiated discount on their homes. Buyers who participate in ORG's down payment assistance program benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals who participate in ORG's down payment assistance program, from real estate brokers to escrow companies, benefit from increased sales volume and an increase in their own compensation. It is evident that ORG's down payment assistance program provides substantial private benefit to the various parties in each home sale.

Unlike the trade or business in *Aid to Artisans, Inc. v. Commissioner of Internal Revenue*, 71 T.C. 202, ORG's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. ORG provided services to home sellers for which it charged a market rate fee. ORG did not market its services primarily to persons within a charitable class. ORG's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. ORG did not solicit or receive any funds from parties that did not have an interest in the down payment transactions. Like the organizations considered in *American Campaign Academy v. Commissioner of Internal Revenue*, 92 T.C. No. 66, 92 T.C. 1053, and *Easter House v. United States*, 12 Cl. Ct. 476, a substantial part of ORG's activities furthered commercial rather than exempt purposes. ORG does not engage in any education, counseling, or other activities that further charitable purposes. ORG's primary activity of facilitating home sales is not conducted in a manner designed to further Section 501(c)(3) purposes. ORG is not operated exclusively for exempt purposes within the meaning of Section 501(c)(3) of the Internal Revenue 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, 66 S. Ct. 112, the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if ORG's down payment assistance program was directed to exclusively low income individuals or disadvantaged communities, the organization's total reliance for financing its down payment assistance activities on home sellers and other real estate related businesses standing to benefit from the transaction demonstrates that the program is operated for the substantial purpose of benefiting private parties.

ORG has not operated exclusively for exempt purposes and is not entitled to exemption from tax under Section 501(c)(3) of the Internal Revenue Code. The government proposes revoking ORG's exemption retroactively to January 1, 20XX because the organization operated in a

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manner materially different from that represented in its application for exemption. In its application for exemption signed under penalties of perjury on October 31, 20XX, and on subsequent attachments, ORG represented that its purpose was to provide down payment assistance for affordable housing for economically disadvantaged persons. Despite these representations, ORG does not have any income limitations for its down payment assistance program, and has provided no indication that it screened for this to determine which applicants qualified for assistance. Rather, ORG's program provided grants to any homebuyers who qualified for a loan provided by CO-1, DIR-1's related for-profit mortgage lending company. ORG did not provide any education or counseling to any of its homebuyers. ORG's operation of its down payment assistance activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of ORG's determination letter.

#### Taxpayer's Position:

On April 14, 20XX, a written response was received from the organization's Power of Attorney, POA-1. The letter states in its entirety as follows:

Thank you for allowing additional time to respond to your draft report on ORG. There are several issues which I wish to address in response to your letter of February 27, 20XX.

In the government's Draft Report 886-A submitted February 27, 20XX, you concluded that, "ORG operated in a manner materially different from that represented in its original application for recognition of exemption. Therefore, revocation of the organization's tax exempt status to January 1, 20XX is proposed." The Service cites as basis for this conclusion many factors among them failure to maintain sufficient records, no screening of applicants for down payment assistance, failure to target a specific population or low-income neighborhood, failure to offer educational information to recipients of down payment assistance, and etc. We disagree.

In 20XX, ORG obtained a positive Determination Letter from the Internal Revenue Service. Internal Revenue Regulations 1.501(a)-1(a)(2) states that an organization may rely upon a favorable determination letter. Since the favorable determination letter was received in 20XX, the managers of ORG relied in good faith upon the determination letter and operated as closely as possible within the plan as designated within the application. It may be true that ORG exempt organization did not maintain as complete set of books and records as the IRS would prefer, however, the organization was a small organization and was not in operation for a long period of time. Since the organization terminated operation and filed Articles of Dissolution, copies of which you have received, it has been difficult locating all of the records maintained by the entity. However, the officers and accountant of the organization assert that the organization operated within the plan submitted in the application for exempt status.

The Service has based its position, in large part, upon Revenue Ruling 2006-27, I.R.S. 2006-21 which is almost identically on point to ORG. IRS Revenue Ruling 2006-27, Situation 2

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describes a circumstance wherein an organization was formed to finance down payment assistance activities very similar to ORG. The revenue ruling concluded that the organization served an exempt purpose but, because it was not operated exclusively for exempt purposes, the organization did not qualify for exemption from federal income tax under IRC Section 501(c)(3). However, the current case involves an ex post facto position for the IRS to impose upon ORG. In 20XX, ORG described this exact plan in its application for exempt status and received an affirmative determination letter. Three years later, IRS issued a Revenue Ruling outlining this same plan and determined that the plan would not qualify for exempt status. For IRS to retroactively apply this Revenue Ruling and revoke the exempt status would be to apply an ex post facto ruling against ORG.

The Service's position is that ORG does not qualify as an exempt organization because it operates a program that does not exclusively serve an exempt purpose described in Section 501(c)(3), and it provides substantial private benefit to persons who do not belong to a charitable class. As stated above, the entity and officers assert that it did operate according to the plan outlined within the application for exempt status. Furthermore, the benefits provided were only to those individuals who applied for and received down payment assistance for home purchases pursuant to ORG plan. The descriptions of the class include the characteristics of home buyers who could not otherwise afford the down payment on a home. In that regard, they not only characterize a charitable class, but daunt the claim that the transactions were intended to exclusively benefit lenders and brokers. In fact, the beneficiaries are the class of borrowers who could not otherwise afford a home or down payment. In that regard, they constitute a charitable class, the fact of which was recognized by the Service in the original grant of exemption.

All income or proceeds received by ORG (over \$ in 20XX) came directly from contributions for down payment assistance programs. Almost all income received by ORG in 20XX was expended for down payment assistance (approximately \$ assistance to purchasers, approximately \$ in financial service costs and fees to arrange mortgages, with a small \$ balance). All fees and costs for financial services paid by ORG were properly reported as income by the service provider and taxed to the recipient service provider. Therefore, there were no private benefits or non-taxed benefits to individuals or companies.

In the event ORG loses its exempt status and is required to file IRS Form 1120 a Corporate Income Tax Return, the result would be negligible. Since the entity was essentially a flow-through entity for down payment assistance payments, all contributions or grants received by the entity were distributed out to home purchasers to be used in down payments. Any incidental amounts not distributed as down payment assistance grants were expended as financial service costs, fees and expenses, all of which would be tax deductible. The result would be that ORG entity would have no taxable income.

In the worst case scenario, if the IRS took the position that the down payment assistance grants were not tax deductible expenditures by the entity, then the IRS would generate a substantial

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corporate tax deficiency. However, since the corporation filed Articles of Dissolution several years ago and the corporation had no remaining assets, there would be no assets upon which the IRS could collect, unless the Service were to attempt to assert some type of penalty assessment against the incorporators or officers, the basis for which is unclear.

Finally, changing market conditions are a reality. If the Service elects to provide greater stability to the home finance market by imposing greater equity requirements, the appropriate response is the termination, not the revocation, of the taxpayer's exemption status. Notwithstanding, the taxpayer would like to resolve this matter with the least expense and proposes to work with the Service to meet its concerns. In that regard and to the extent that additional information or dialogue are required, the taxpayer has directed this office to cooperate with the Service in every regard.

#### Government's Response to Taxpayer's Position:

The organization's Power of Attorney, POA-1, assisted the organization in obtaining tax-exempt status which was originally granted to ORG on March 6, 20XX. POA-1 continues to represent the organization during the examination of its 20XX Form 990.

POA-1 acknowledges that Revenue Ruling 2006-27, I.R.B. 2006-21, Situation 2 is almost identical to the activities engaged in by ORG during the year under examination. The revenue ruling states that organizations that are funded by sellers of homes or parties interested in the sales of homes, and that do not maintain the anonymity of such seller and interested parties, are not exclusively operated for a charitable purpose, and therefore, tax exempt treatment is improper. However, POA-1 claims that Revenue Ruling 2006-27 represents an ex post facto ruling against ORG.

Revenue Ruling 2006-27 is merely an interpretation of long standing exempt organization law. The Internal Revenue Service is not proposing revocation of ORG's tax-exempt status based upon retroactively applying Revenue Ruling 2006-27, I.R.B. 2006-21, to the organization's activities. The purpose of including the revenue ruling in the report is to illustrate the Internal Revenue Service's position with regard to a similar set of facts. The proposal to revoke ORG's tax exempt status is based upon the organization's failure to operate in accordance with furthering the tax exempt purposes as described in Section 501(c)(3) of the Internal Revenue Code. Public Law 83-591 added Section 501(c)(3) to the Internal Revenue Code effective August 16, 1954, well before ORG began operating.

POA-1 also states that ORG described the plan as illustrated in Situation 2 of Revenue Ruling 2006-27; I.R.B. 2006-21, in its application for tax exempt status. POA-1 cites Federal Tax Regulation Section 1.501(a)-1(a)(2), which states an organization that has been determined by the Commissioner to be exempt under Section 501(a) may rely upon such determination so long

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as there are no substantial changes in the organization's character, purposes, or methods of operation.

However, the Internal Revenue Service maintains that the representations made by POA-1 when describing the organizations proposed activities during the application process were not an accurate representation of the organization's true operations. Accordingly, there has been a substantial change in the organization's character, purposes and methods of operation from that described in its application for exemption. Below are five specific material facts which were not disclosed in the Form 1023 application filed by ORG. These material misrepresentations justify the revocation of the organization's tax exempt status retroactively back to the date of its inception.

1. In the application process, the Internal Revenue Service relied upon the statements that contributions may come from charitable contributions and "unrelated mortgagors and borrowers". The Form 1023 application failed to disclose that the vast majority of contributions to ORG would come from a for-profit mortgage lending company controlled by DIR-1, from the sellers of homes to grant receiving buyers, and from other real estate entities which receive a direct benefit from the home sale transaction.
2. The application for exempt status stated that ORG would have an office located at Address in City, State from which it would conduct the down payment assistance management program, that the office facility would not be used by any other entity other than ORG, and that none of the directors or employees would reside at the facility. However, records obtained from the County Assessor's website and from the Internal Revenue Service's internal records revealed this location to be the personal residence of ORG's President, DIR-1. Moreover, DIR-1's for-profit entity also has its offices located at Address in City, State. These facts were materially misrepresented during the application process. Use of the offices of ORG would amount to a significant non-exempt benefit to DIR-1 and to his for-profit entity.
3. POA-1 stated in the determination application that the only prospective officer of the organization is DIR-1 who, as President, would administer all of the activities of the organization. POA-1 also stated that ORG does not have a definitive relationship with any for-profit mortgage company or similar entity. On December 6, 20XX, POA-1 provided a written statement again maintaining that ORG has no directly affiliated or related entity. However, POA-1 acknowledged that the principal of ORG, DIR-1, is also principally involved in a mortgage lending company called CO-2 ) An analysis of the organization's 20XX Form 990 revealed that ORG paid \$ in financial service costs to CO-1, which is for-profit mortgage lending company controlled by DIR-1. The company was formed under the laws of the State of State on February 22, 20XX, prior to the filing of the Form 1023. Payments to this entity result in a significant non-exempt benefit to DIR-1 which was not disclosed during the application process.

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4. The Form 1023 application for exemption failed to disclose the material fact that an officer and a director had a significant connection to the local real estate industry. Research of the State Real Estate License Verification System's website disclosed the following licenses:

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This material omission from the organization's Form 1023 application changes the character of the organization from an organization operated exclusively for charitable purposes, to that of an organization operated primarily by and for the benefit of individuals receiving a private, non-exempt benefit from the organization, specifically, the benefit of business generated for their related for-profit activities.

5. During the application process, POA-1 stated that the sellers of the homes would be entitled to participate in the down payment assistance program, but would not be required to donate a percentage of the selling price of the home to ORG. However, on December 6, 20XX, POA-1 provided a copy of the seller participation letter which he acknowledged was used by ORG during the year under examination. The letter contradicted POA-1's previous description of how ORG's down payment assistance program would operate as described in the determination application. The seller participation letter stated that the seller would agree to give as a donation to ORG, a Section 501(c)(3) organization, a percentage of the contract sales price. The seller participation letter also stated that if for any reason the transaction did not close and record, the seller would have no obligation to give a donation to ORG. This material difference in method of operation from the method of operation described during the organization's 1023 application process changes the character of the organization from an organization supported by disinterested parties, to that of an organization supported primarily by individuals receiving a private, non-exempt benefit from the organization, specifically, the benefit of an expedited sale of their homes.

Moreover, the favorable determination granting ORG tax exempt status specifically stated that the ruling was based on the understanding that if the organization distributed funds to individuals, the organization should keep case histories showing the recipients names, addresses, purposes of awards, manner of selection, and relationship (if any) to members, officers, trustees, or donors to the organization, so that ORG could substantiate any and all distributions that the organization made to individuals upon request by the Internal Revenue Service. ORG did not maintain most of these records. Clearly, in many material respects, the operations of ORG were not carried out as contemplated in the favorable determination letter granting tax exempt status.

**Conclusion:**

In 20XX, ORG operated in a manner materially different from that represented in its original application for recognition of exemption. Therefore, revocation of the organization's tax exempt status to January 1, 20XX is proposed. Form 1120 returns should be filed from the period

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January 1, 20XX through November 22, 20XX, when ORG terminated its corporate status with the State of State.