



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Number: **200450038**

Release Date: 12/10/04

Date: September 14, 2004

UIL Index  
501.03-05

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Key

A =

B =

U =

V =

X =

Y =

Dear :

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

According to the information provided by you, you are a domestic nonprofit corporation. You are controlled by a board of two directors; you plan to enlarge the board after being recognized as exempt. Your application Form 1023 provides that your mission is to provide relief to the poor and financially disadvantaged by providing a vehicle by which such individuals can become homeowners. Your Articles of Incorporation state that you were formed to provide financial relief, homeownership opportunities and educational support to low and moderate income persons, to lessen the burdens of government by operating a lease-to-own and closing cost assistance program.

Your primary activity is your lease-to-own program. In response to our question regarding prior governmental activity in this area, you stated that you were not aware of any prior governmental activity and that your program would not be subject to governmental supervision.

You will use the lease-purchase mortgage program of X, an unrelated mortgage lender, which is limited to government and 501(c)(3) borrowers. You currently do not have any formal agreement with X to provide this program. In addition, you currently do not meet all of the requirements stated in X's guidelines, but X is giving you "special consideration" in receiving

approval to use the program based on the previous operations of Y, a for-profit entity that previously conducted the same activities and was operated by your directors.

Under the lease-to-own program, you will purchase a home under owner-occupied terms that you will then lease to low and moderate-income individuals and families with a pre-negotiated purchase option. This program gives prospective homebuyers a property lease on the home of their choice for a fixed time period and will eventually enable the person to purchase the property from you at the end of the lease term. You do not limit the area in which your properties are located or where you will provide program services.

Your program is available to low and moderate-income individuals and families who cannot currently qualify or afford to purchase a home, based on the income and program guidelines followed by X. The guidelines include the following criteria for screening applicants: (1) applicants must fall within the guidelines for low and moderate-income (using the HUD definitions of 80% of area median income and area median income, respectively), (2) applicants must obtain median credit scores above 560, (3) applicants must have a 2-year income verification and job history, (4) applicants must provide a 2-year rental history, (5) applicant must not be a current homeowner and (6) applicant must agree to have a background review including criminal record search. In addition, each applicant must submit a written application, documenting financial need and ability to meet financial obligations.

You indicate several benefits to tenant-purchasers by purchasing through the program:

- Fixing the purchase price in advance with a formula that limits annual price increases to no more than 5%
- Locking in today's low interest rates
- Forced saving of down payment
- Larger loan than the tenant could otherwise qualify for

A typical tenant-purchaser encounter involves the following: new applicants are either referred to you or individually call in based on your advertisements. Referrals come from other nonprofit housing organizations, mortgage companies, real estate professionals, past tenant-purchasers or property developers. You conduct a telephone screening, and if the call indicates that the client may qualify, you set up an initial qualification meeting to review and discuss the application and credit report.

After an application is received, it must be approved by a committee. The committee is currently composed of your two officer/directors, A and B. Upon approval of the application, you work with the applicant to select, negotiate, and purchase a home. The tenant-purchaser's information is then forwarded by the screening committee to the lender for pre-qualification for a mortgage. If approved by the mortgage lender, you present the tenant-purchaser with a home buyer action plan and the established home price that the tenant-purchaser can afford.

In addition, you assign a real estate agent from your list of agents. You state that you maintain a list of real estate agents that you have screened for experience and commitment to affordable housing programs. These agents attend an orientation session on how your program operates. You state that the real estate agents are not compensated by you but rather receive compensation through the sale or purchase of the home.

The real estate agent assigned to your tenant-purchaser will work with the tenant to select a property and notify you of the selected property. If there is mutual acceptance by you and the tenant-purchaser, you schedule a property inspection and finalize the sale. Once you have purchased the property, you will rent or lease the property to the applicant. An applicant must provide you with an initial down payment consisting of a \$ commitment fee, plus one-half of a monthly payment for maintenance and the first and last month's payments. Mortgage payments may be as low as \$ , assuming the property's purchase price is approximately \$ . This would mean that an applicant with a mortgage of \$ must provide you with an initial down payment of at least \$ to participate in your program.

The X program requires that the applicant be both pre-qualified (before entering the lease) and re-qualified by the lender immediately prior to the mortgage assumption to verify ability to make on-time payments. X's initial qualification will be based on the underwriting of the mortgage lender including information on your financial position as well as the tenant-purchaser's financial statements. X is depending on you to represent and plan how the tenant-purchaser will qualify for the mortgage at assumption time.

In addition, the X program requires that the applicant's monthly payment include an amount sufficient to meet all of the nonprofit entity's operating costs for the property (including principal, interest, taxes, insurance, and any other assessments) and an amount sufficient to ensure an accumulation of funds equal to the minimum required down payment by the end of the lease term.

The residential lease and option-to-purchase agreement provides that the tenant is responsible for making all necessary repairs and maintenance. The monthly maintenance fee does not provide any included maintenance work for the tenant-purchaser. The fee is to provide a level of assurance that the properties will be maintained while they are owned by you.

The purchase-price option is based on a calculation estimating the future value of the property at the end of the lease term. You are bound by the lease-option agreement to transfer the property at the stated price if the appraised value meets or exceeds the option price. If the appraised price of the property is less than the option price, you have the option of agreeing to the reduced price, requesting a reappraisal or denying the option. If an option is denied, the tenant-purchaser is allowed to continue leasing the property from you.

You state that your program provides a prospective purchaser with an alternative to renting or entering into alternative financing with a predatory lender. You state that by using your program, persons who would not otherwise qualify for a mortgage will be able to live in a home, earn equity, receive counseling and ready themselves for the purchase of a home.

The contracts contain incentives for the tenant-purchaser to ultimately purchase. 10% of the rent payment is set aside for down payment costs, and these funds are forfeited if there is no purchase. There is a \$      fee for a 6-month extension of the lease.

In addition to your lease-to-own program, you will provide homeowner education, credit counseling services, and ongoing monitoring and counseling as part of the lease-purchase agreement between the applicant and yourself. You plan to use other organizations who offer down payment assistance, and credit repair services will be outsourced. You will seek new employees with credit counseling experience

You anticipate receiving the majority of your financial support from fees from the lease-to-own program, and gifts, grants and contributions by individuals, government agencies, corporations and other nonprofit organizations. You do not have any formal agreement with other community organizations, but informal relationships with organizations that will offer homebuyer education, property management, and the pool of potential homebuyers. You anticipate offering these services including maintenance, repair, and other such homeowner services through third parties. You state that the maintenance and repair service fees will be below market rates. In addition to these entities, you plan on establishing a formal relationship with specific real estate agents who will regularly represent you and your tenants.

A review of your Internet website provides a link to two for-profit entities: U (with a name similar to yours) and V. U is the DBA of a bank branch office. Its branch manager is B, an officer and director of you. You state that the name of the entity is purely coincidental to yours and that there is no current or past relationship between yourself and U. V is a real estate agency with which your two officers and directors, A and B, are independent contractors. You state that there is no management interest or agreement between V and you. Also, you state that A and B will not provide real estate or mortgage services to you. You state that the links are provided only as references for prospective tenant-purchasers.

Section 501(c)(3) of the Internal Revenue Code provides an exemption from taxation for organizations organized and operated exclusively for charitable and educational purposes including for the prevention of cruelty to animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations states that an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

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 under section 501(c)(3) of the Code unless it serves a public rather than a private interest. In order 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 such as designated individuals, the creator, shareholders of the organization or persons controlled, directly or indirectly by such private interests.

Section 1.501(c)(3)-1(d)(2) of the Regulations defines the term “charitable” as including the relief of the poor and distressed or of the underprivileged, lessening the burdens of government, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

Rev. Rul. 67-138, 1967-1 C.B. 129 holds that a nonprofit organization created to provide instruction and guidance to low-income families in need of adequate housing and interested in building their own homes is exempt under section 501(c)(3) of the Code. The organization’s training of low-income families on various aspects of house building and homeownership was educational. The activities related to assisting families find adequate housing was charitable as it provided relief to the underprivileged, lessened the burdens of government and was a means of combating community deterioration.

Rev. Rul. 68-17, 1968-1 C.B. 247 provides that a housing program for low-income families and disseminates information about the results of the program may qualify for exemption from Federal income tax under section 501(c)(3) of the Code. The purposes and activities of the organization pertaining to its demonstration program were educational, charitable and combated community deterioration within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 70-585, 1970-2 C.B. 115, holds that providing housing for low income families furthers charitable purposes within the meaning of § 501(c) (3). The ruling also holds that providing housing for low and moderate income families furthers charitable purposes if the activity is part of a program that eliminates prejudice and discrimination or combats community deterioration. However, providing housing to moderate income individuals does not, alone, further a charitable purpose.

Rev. Proc. 96-32, 1996-1 C.B. 717, set forth a safe harbor under which organizations that provide low-income housing will be considered charitable for relief of the poor and distressed, and described the facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed. It also clarified that housing organizations may rely on other charitable purposes to qualify for recognition of exemption. The safe harbor requires that the housing be affordable to the charitable beneficiaries. In the case of rental housing, this requirement will ordinarily be satisfied by the adoption of a rental policy that complies with government-imposed rental restrictions or otherwise provides for the limitation of the tenant’s portion of the rent charged to ensure that the housing is affordable to low-income and very low-income residents. In the case of homeownership programs, this requirement will ordinarily be satisfied by the adoption of a mortgage policy that complies with government-imposed mortgage limitations or otherwise makes the initial and continuing costs of purchasing a home affordable to low and very low-income residents. Facts and circumstances that demonstrate relief of the poor may include, but are not limited to, the following:

- (1) A substantially greater percentage of residents than required by the safe harbor with incomes up to 120 percent of the area’s very low-income limit.

- (2) Limited degree of deviation from the safe harbor percentages.
- (3) Limitation of a resident's portion of rent or mortgage payment to ensure that the housing is affordable to low-income and very low-income residents.
- (4) Participation in a government housing program designed to provide affordable housing.
- (5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization's operations.
- (6) The provision of additional social services affordable to the poor residents.
- (7) Relationship with an existing 501(c)(3) organization active in low-income housing for at least five years if the existing organization demonstrates control.
- (8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.
- (9) Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.
- (10) Existence of affordability covenants or restrictions running with the property.

In Better Business Bureau of Washington, D.C. v. U. S., 326 U.S. 279 (1945), the court held that an organization was not organized and operated exclusively for charitable purposes. The court reasoned that the presence of a single nonexempt purpose, if substantial in nature, would destroy the exemption regardless of the number or importance of truly exempt purposes.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), a nonprofit organization paid a for-profit corporation for the licenses to conduct "est" programs. The est programs involved training, seminars, and lectures in the areas of intrapersonal awareness and communication. The court held that an organization's denial of exemption was proper because the organization had a substantial commercial purpose that served private rather than public interests. Although the nonprofit claimed that it had no connection, direct or indirect with the for-profit, the court found that the for-profit exerted considerable control over the nonprofit's activities. The nonprofit's only function was to present to the public for a fee, ideas that were owned by the for-profit with materials and trainers supplied by the for-profit. Regardless of whether the payments made by the nonprofit to the for-profit were excessive, the for-profit benefited substantially from the operation of the nonprofit. The nonprofit was the instrument to subsidize the for-profit corporations and not vice versa and had not life independent of the for-profits.

In KJ's Fund Raisers, Inc. v. Commissioner, 74 T.C.M. 669 (1997), the court held that a nonprofit organization, which sold lottery tickets on the premises of a for-profit business had a substantial non-exempt purpose to enhance the profits of the for-profit business. The owners of the for-profit business to purportedly raise funds for distribution to charitable causes formed the nonprofit organization. The nonprofit's lottery tickets were sold during the regular business hours by the owners and employees of the for-profit business. The owners of the for-profit initially controlled the board and later indicated that it would vest control in unrelated parties. The nonprofit opined that the organization "would fold without the original founders of the organization as officers." In finding that the nonprofit had a substantial nonexempt purpose, which was promoting the for-profit, the court reasoned that the identity of the for-profit owners and the officer of the nonprofit placed the owners of the for-profit in a position to control the nonprofit. Additionally, the court found that the publicity received by the for-profit was a significant benefit.

You have failed to establish that your operations will further a charitable purpose and that you will not be operated for a substantial nonexempt private purpose.

You have failed to establish that you will be operated exclusively for one or more charitable purposes, through relief of the poor and distressed, lessening the burdens of government, combating community deterioration, or otherwise.

Regarding relief of the poor and distressed, you have not established that you will serve the poor. While you may deal with many persons who are considered low-income, you have not established that you will meet the safe harbor of Rev. Proc. 96-32 for dealing with "low-income" persons. Moreover, it appears that many, perhaps most, of your tenant-purchasers will not be low-income, let alone very-low-income. Nor have you established that merely not owning a home qualifies a person as "distressed."

To relieve the poor by providing housing, an organization must make the housing costs affordable. In your case, you engage in both the rental and sale of housing. While the primary focus of your program is on homeownership, you have not established facts demonstrating that you will make rental costs affordable, such as through government-imposed rent restrictions or limitations of rent to an affordable level. Instead, it appears that rents will be at market rates, and there are penalties for tenants to rent without purchasing the property.

Moreover, you lack many favorable factors set forth in the facts-and-circumstances test, such as serving excess very-low-income persons, limitations on rent or mortgage payments to a fixed percentage of income, participation in a government affordable housing program, a community-based board, relationship with an existing 501(c)(3) organization, and affordability covenants running with the property.

Nor have you established a charitable purpose other than relief of the poor. Regarding combating community deterioration, you will provide your services without regard to location. You have not established that you will renovate housing in slum areas or otherwise combat community deterioration. Regarding lessening government burdens, you have not established that the government considers your activity to be its burden, or that you will relieve its burden.

You have not shown government establishment of you, government control over you, government funding of you, or other close relationship with government.

You also have failed to sufficiently establish that your activities will not serve the private interests of your pool of real estate agents, U or V or their owners, directors, and officers. You state that you do not compensate the real estate agents you assign to tenant-purchasers; however, the fact that you have a pool of agents and you assign these persons to your clients indicates that you are providing a commercial referral service to a limited number of persons.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization does not operate exclusively for exempt purposes if it operates for the benefit of private interests. You state that you are not affiliated with either U or V. However, the Internet links between the companies and you, the similarities in name between yourself and U, and the cross over between your board members and officers with members and employees of U and V indicate that while you exist as a separate legal entity, your activities serve the substantial nonexempt purpose of operating for the benefit of the commercial purposes of these for-profit entities. est of Hawaii, supra and KJ's Fundraisers, Inc., supra. As stated in Better Business Bureau of Washington, D.C., supra, 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.

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

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

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service,

TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, and do not intend to protest our denial of exempt status, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If you also disagree with our proposed deletions, you should send your comments on the deletions with your protest statement, and not to the address shown in Notice 437. If it is convenient, you may fax your reply using the fax number shown in the heading of this letter.

Internal Revenue Service  
TE/GE (SE:T:EO:RA:T:2)

1111 Constitution Ave, N.W.  
Washington, D.C. 20224

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

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

Sincerely,

Ward Thomas

Lois G. Lerner  
Director, Exempt Organizations  
Rulings & Agreements

Enclosure  
Notice 437

Bcc: