



DEPARTMENT OF THE TREASURY

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

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

January 6, 2009

Number: **200915059**
Release Date: 4/10/2009

LEGEND UTIL:501.03-01
ORG = Organization name XX = Date Address = address

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

CERTIFIED MAIL - RETURN RECEIPT

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: April 6, 20XX

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective July 1, 20XX. You have agreed to this change per signing of the Form 6018, dated October 30, 20XX.

Our adverse determination was made for the following reasons:

Inurement and/or private benefit of an IRC Section 501(c)(3)'s assets in any form or amount is prohibited. ORG has not been operating exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). ORG also is not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. You operate substantially for a non-exempt purpose; the providing of private rather than public benefits.

You failed to meet the requirements of IRC section 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for a substantial non-exempt purpose; providing debt negotiation and debt settlement services.

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 July 1, 20XX, and for all years thereafter.

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

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

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

You can call 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 or writing:

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,

Renee B. Wells
Acting, Director EO
Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
Exempt Organizations Examinations 7954
7850 SW 6th Court
Plantation, FL 33324

September 10, 2008

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

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

If you accept our findings, 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,

Vicki L. Hansen
Acting, Director EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		June 30, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State City = city
 website = website President = president Secretary = secretary
 Treasurer = treasurer CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7, CO-8, CO-9, CO-10 & CO11 = 1ST, 2ND, 3RD, 4TH, 5TH, 6TH, 7TH, 8TH, 9TH, 10TH & 11TH COMPANIES

ISSUES

Does ORG continue to qualify for tax-exempt status under section 501(c)(3) of the Internal Revenue Code as a credit counseling organization operated for section 501(c)(3) purposes, primarily educational purposes?

Does ORG have a substantial non-exempt purpose by providing debt management program services to the general public?

Whether ORG is operated for the purpose of serving a private benefit rather than public interests?

FACTS

Background:

The Articles of Incorporation filed July 13, 19XX in the State of XYZ stated the primary purpose of ORG was consumer debt counseling. On December 26, 19XX, ORG filed articles of amendment to amend its purpose to provide consumer debt counseling which are exclusively literary and educational within the meaning of section 501(c)(3) of the Internal Revenue Code of 1986 or the corresponding provision of any future United States Internal Revenue Law.

The following individuals were listed as ORG's officers:

President	President
Secretary	Secretary
Treasurer	Treasurer

Form 1023 Application:

The Form 1023, Application Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code stated the activities of ORG (ORG) were:

ORG is an organization formed to help incidence of personal bankruptcy by informing the public on personal money management and by assisting low-income individuals and families who have financial problems. ORG will work to educate the public of the uses and abuses of consumer credit and provide information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications.

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Name of Taxpayer ORG		Year/Period Ended June 30, 20XX

The organization will provide consumer credit and budget counseling to families and individuals, especially low income families and individuals who are in need of assistance by providing one on one counseling and, if necessary, by establishing budget plans. Under the budget plan, these needy individuals voluntarily make fixed payments to the organization. The funds are then kept in a trust account and disbursed on a partial payments basis to the creditors, whose approval of the establishment of the plan is obtained by the organization.

The organizations primary source of financial support is contributions from creditors participating in the organizations budget plan. The creditors are not required to make contributions as a condition of participation. A minimal fee is charged for participation to cover administrative costs.

Participants in the budget plan and disbursements service are charged a \$ origination fee and a \$ monthly service charge. Both fees are intended to cover a portion of the administrative costs of this program.

The personnel of ORG will counsel individuals or couples by appointments, at the present time, in our main office as to the best avenue of choice in helping relieve them of their debt burden. We take them STEP by STEP into our debt management program and show them what we can and cannot do to help them. We apprise them of the various methods of accounting the credit card companies use to reflect their interest fees, late charges and accrued late payment fees. We show them various newspaper articles explaining the good and evil of credit cards and the results of overcharging. If the individual or couple are satisfied with our counseling and feel that our debt management program can help them they join our program. From that point we handle all their creditors and arrange for timely and lower payments. We also handle and manage any problems that might arise during that period. On the average if the client stays on our programs to the end we will manage to get them debt free within 36 to 42 months.

The service is performed on a "NO FEE" basis. The only fee that will be charged is for the monthly mailouts and the proposal mailouts to the various vendors and client notices.

IRS Correspondence Request for Additional Information to Make Determination of Exempt Status:

IRS correspondence dated December 13, 19XX, was mailed to ORG requesting additional information. ORG correspondence dated January 11, 19XX, was mailed to the IRS in response to request.

One of the questions in the IRS letter inquired about ORG's sources of income. In response to the question, ORG provided the following response:

Q= Question-IRS

A=Answer-ORG

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1. Q. During our review we noticed that you reported sources of income as a \$\$ origination fee and a \$\$ monthly service charge. Explain who will actually be required to pay these fees. Will it be the creditor, the consumer, both or another source? Explain in detail.
1. A. The \$\$ origination fee previously mentioned is NOT charged to the average client as a practice. It is only charged to the client if the volume of debt and the time needed for debt management is overwhelmingly large.

The \$\$ monthly maintenance fee, as previously explained, is a fee needed to overwrite the expense of the letters of proposals to the clients debtors and the required mailing of payments, and notifications to clients keeping them abreast of their financial standing. This charge also helps offset the numerous phone calls involved. The client (consumer) will be responsible for this fee. The fee is WAIVED in extreme hardship cases.

In a letter dated January 29, 19XX, ORG was recognized by the Internal Revenue Service as exempt from Federal income tax as an organization described in section 501(c)(3) of the Code.

Credit Counseling and Debt Management Program Activities:

During the examination year ended June 30, 20XX, ORG's Form 990 described its primary purpose and program achievements as follows:

Primary Exempt Purpose: Help reduce incidences of personal bankruptcy by providing information, education and money management assistance	Program Service Expenses
Exempt purpose achievements:	
a) Provided consumer credit and budget counseling to families and individuals; established budget plans wherein fixed partial payments were remitted to creditors	\$\$

ORG provides its credit counseling services primarily by telephone and occasionally has face-to-face counseling. ORG has two full-time counselors. The primary counselor has a 10th grade education and no prior financial or budgetary counseling experience. ORG's other counselor, also its president, states to be a certified personal financial counselor. Per ORG the primary counselor has not received any formal training; all training was provided directly from the president of ORG. The counselors handle incoming telephone calls from the general public in response to website and local advertising targeted at individuals experiencing credit problems.

During the field examination, the EO Agent requested to listen to counseling sessions either via telephone or during a one-on-one counseling. No counseling sessions took place during the field examination for the EO Agent observe, however, ORG provided counselor transcripts for the

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following: potential clients issued education text, phone counseling/text issued, clients enrolled with face-to-face counseling sessions, and consumer program reviewed and re-counseled list. The transcripts contained the clients, name, city and state, and a brief message stating if a message was left for an internet potential client, whether the packet with educational text was mailed, and if client signed up for program. With the exception of the clients enrolled with face-to-face counseling notes, ORG did not mention how much time was spent on the telephone counseling sessions. Additionally the notes did not detail any critical analysis of the caller's budget.

The EO Agent reviewed 14 client files maintained by ORG. None of the files reviewed contained documentation for counseling sessions. The files contained only information relating to the client's DMP accounts. Typically, the documents contained in client files included the following items:

- Enrolle Budget Intake Form
- DMP Affidavit and Release Form
- Welcome Letter with payment amount due
- Debt Work Sheet
- Proposal request
- payments
- DMP related correspondence and other account data

The debt management services ORG provides consists of enrolling individuals who qualify into a debt management program (DMP). Once ORG enrolls clients into its DMP program, their file is transferred to CO-1, a for-profit organization referred to as ORG processing center, for processing. CO-1 negotiates client contracts and credit proposals, in addition too, collecting and disbursing client payments.

ORG requests a one-time creditor mandated budget proposal compliance charge, a refundable program completion charge and monthly payments from its clients for its DMP services. It advises individuals in its Affidavit and Release Form that the monthly expense contribution and any set-up contribution are made voluntarily to defray expenses incurred by ORG in creation and administration of client's DMP. The Affidavit also stated that making a payment directly to a creditor while enrolled may result in the termination of the plan.

ORG also requests payments from creditors for its DMP services. When DMP proposals are sent to creditors by CO-1, they are asked to participate in a voluntary fairshare donation program at a specified percentage level. If a creditor agrees to participate in the fairshare donation program, it is then requested to indicate if it wants ORG to deduct the fairshare donation from client remittances or if it wants to be billed for the fairshare donation.

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During the year ended June 30, 20XX, ORG's income was generated from program service fees, fair share payments, and grants. As evidenced below, 59% of ORG's revenue comes from fees and fair share payments received and the remaining income represents grants received from two credit card companies and a for-profit organization.

Per Books	
Client Program Fees Received	
Counseling Services	
Fair Share Payments Received	
My Clean Start Grants	
CO-2 Grants	
CO-3 Grants	
Other Income	
Outreach Administration Services	
Total	

During the examination, the Examining Agent reviewed some of the documentation which accompanied the grants. In letters from CO-2s dated August 24, 20XX and November 27, 20XX, they stated that CO-2's grant program provides support to qualifying agencies according to their financial needs and based on the benefit they provide to consumers and the public at large. The letters also state that qualifications for grants are determined by the information submitted in grant applications and other relevant factors evaluated based on CO-2's discretion. Finally the letters state that the receipt of a grant in any given calendar quarter does not mean your agency will or will not receive a grant in the future and amounts may vary from quarter-to-quarter and/or year to year-to-year. ORG received grants from CO-2s in the amount of \$\$ and \$\$, respectively, based on the letters.

In an email from CO-3 dated April 13, 20XX, it states that ORG's grant application has been approved in the amount of \$\$ and the funds will be directed to the account number currently used to receive fair share disbursements. The purpose of the grant was to provide funding to support ORG's education counseling sessions and outreach programs.

On April 20, 20XX ORG entered into a contract with CO-4, a for-profit entity, to develop education and counseling programs for ORG through its community outreach efforts. The terms of the contract also stated the CO-4 shall donate to ORG for use of its resources to qualify consumers for various services offered by ORG. **See Exhibit # 1 for contract.** Per ORG, CO-4 provided grants for ORG to provide counseling and pull credit reports for first time homebuyers. ORG ceased its arrangement with CO-4 in June of 20XX.

Educational Activities:

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ORG's educational activities consist of conducting seminars at different venues and distributing educational texts, in addition too, maintaining a website.

ORG's website is located at website. The website's welcome page contained the following questions under the frequently asked questions section:

1. How do I enroll?
2. Can I keep my credit cards?
3. Is there a fee to enroll?
4. How can our program help you?
5. Is there any effect on credit reports?
6. Can you reduce interest payments?
7. Will my monthly payment be reduced?
8. What is a "fixed monthly payment"?
9. Benefits of the program
10. CONSUMER EDUCATIONAL TEXT

The Consumer Education Text web page contained an excerpt from the organization's educational text "Surviving Debt". The purpose of the excerpt was to inform and guide individuals through best available choices. Individuals had to call the organization in order to receive a free of copy of the complete educational text.

The welcome page also offered FREE FINANCIAL ANALYSIS in which the consumer had to fill out the Monthly Intake and Debt Worksheet forms. The Monthly Intake page requests the potential client's name, email address, home address, phone number, past due time frame, total net monthly income, and total monthly household and living expenses. There is a disclaimer at the bottom of the webpage the states in part, "A counselor will contact you as soon as information is received and your accounts are verified and configured for our plan." The Debt Worksheet requests the potential client's name, phone number, creditor name, current balance, and current payment. Additionally there is a Sample Savings Chart page to illustrate to potential clients the difference between repaying creditors on their own or repaying on ORG's budget plan.

ORG modified the appearance of its website on April 14, 20XX. Prior to the modification the welcome page contained all the aforementioned data in addition to the following frequently asked questions:

- ✓ Consolidate Debt
- ✓ Lower Interest Rate Charges
- ✓ Lower Monthly Payments
- ✓ Stop Harassing Phone Calls
- ✓ Avoid Bankruptcy

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The educational materials distributed by ORG in included: *Surviving Debt, Beware of Credit Card Tricks, A Student Guide to Financial Aid and Services, Consumer Budgeting and Savings Text, and Potential Client Advice Document*. The educational materials were distributed to individuals who attended seminars and mailed to individuals who contacted ORG for information and/or counseling.

ORG provided a list of all educational seminars conducted during the year under examination. Based on the list, the organization held seminars locally and in surrounding cities. All of the seminars were conducted by the President of ORG, Treasurer. A number of the events on the list provided do not appear to be seminars presented the ORG, but events attended by ORG. Some of the topics discussed during the workshops included: how to improve credit scores, pitfalls of unsecured debt verses none secured debt, surviving debts and financial budgeting tips, what it takes to get back on your feet, etc. ORG provided a seminar script used during the presentations which outlines discussions on budgeting, how to make a budget, and an excerpt from *Surviving Debt*. Occasionally, ORG also held joint seminars with a lawyer or a representative from to discuss bankruptcy and mortgage related issues. The organization said it advertised these seminars through flyers, but no flyers were maintained. **See Exhibit # 2 for complete list of seminars**

The following statistics were provided by ORG for the tax year ended June 30, 20XX:

- 250 total sessions (including seminars and re-counseling)
- 105 DMP Sessions
- 59 Client Enrolled

ORG states that their DMP counseling sessions represent 42% versus all activity conducted and only 23.6% of total sessions resulted in a client enrolling in a DMP.

Service Agreements:

On December 31, 20XX ORG entered into a service agreement with CO-1, a for-profit corporation, to provide payment processing. In the service agreement, the scope of services provided by CO-1 included:

- a Collecting client payments
- b Processing client receipts
- c Submitting payments to creditors
- d Balancing trust account activities
- e Mailing late letters
- f Researching returned checks and ACH payments
- g Processing AGENCY fees
- h AGENCY and client management system

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i AGENCY consulting services

The agreement also states that CO-1 would provide consulting services which include: establishing workflows; developing AGENCY documentation and training; assisting in state licensing; AGENCY organization and operations.

The terms of the agreement required ORG to maintain and afford CO-1 full access to one or more accounts for deposit of budget payment plan payments from clients, the disbursement of refunds, to clients, and the disbursement of payments to creditors. ORG may periodically transfer amounts from accounts maintained by CO-1 to its operating accounts amounts representing contributions from clients and/or fair share contributions. CO-1's compensation for services included: \$ per month per client; system customization services at \$ per hour; workflow and quality manual documentation at \$ per hour; state licensing assistance at \$ per hour. CO-1 was authorized to deduct its fees from ORG's revenues to the extent owed. The agreement was valid for three years. **See Exhibit # 3 for complete agreement.**

ORG also has management agreements with two for-profit entities, CO-5 and CO-6 located in City, XYZ to provide financial/budgeting counseling and to enroll potential clients in ORG's debt management program. These for-profit entities were portrayed as satellite offices of ORG. According the agreements, all clients enrolled in ORG's DMP via the for-profit entities will remain active client of ORG in event of termination. Compensation would be 25% of amounts collected by ORG for services rendered or activities carried on at the Center by Manager. There is a minimum term of 2 years, and in the event of termination (4 year minimum) ORG shall pay 50% of fair share amounts collected by ORG enrolled clients monthly receipts to the for-profit entities until the last enrolled client makes the last payment. **See Exhibit # 4 for agreements.**

According to ORG, these satellite offices are paid a management fee generated by the amount of fair share and service fees received monthly by clients that were counseled by the satellite office and after counseling it was determined that the client was also in need of a debt management program. The client is transferred to ORG for program counseling and program enrollment. The fair share due to the satellite office is determined by each enrolled clients monthly creditor payments. This amount is paid directly to the satellite office minus a \$ CO-1 processing fee; of which \$ goes to CO-1 and \$ goes to ORG for continued servicing of client accounts.

LAW

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

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Section 1.501(c)(3)-1(b)(1)(i) of the Code provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its "articles") as defined in subparagraph (2) of this paragraph:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interest, such as designated individuals, the creator or his family, 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 provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

- (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
- (b) The instruction of the public on subjects useful to the individual and beneficial to the community.

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Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

In *Better Business Bureau of Washington D.C., Inc. v. United States*, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In *American Institute for Economic Research v. United States*, 302 F.2d 934 (Ct. Cl. 1962), the Court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The Court noted that education is a broad concept, and assumed arguendo that the organization had an educational purpose. However, the totality of the organization's activities, which included the sale of many publications as well as the sale advice for a fee to individuals, was indicative of a business. Therefore, the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

In *Consumer Credit Counseling Service of Alabama, Inc. v. United States*, 78-2 U.S.T.C. 9660 (D.D.C. 1978), the court held that an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational.

The Consumer Credit Counseling Service of Alabama is an umbrella organization made up of numerous credit counseling service agencies. These agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they did provide such services free of charge. As an adjunct to the counseling function, they offered a debt management plan. Approximately 12 percent of a professional counselor's time was applied to the debt management plan as opposed to education. The agencies charged a nominal fee of up to \$10 per month for the debt management plan. This fee was waived in instances when payments of the fee would work a financial hardship. The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from service fees.

The court found the organizations exempt under section 501(c)(3) because providing information to the public regarding the sound use of consumer credit is charitable in that it advances and

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promotes education and social welfare. These programs were also educational because they instructed the public on subjects useful to the individual and beneficial to the community. The counseling assistance programs were likewise charitable and educational in nature. Because the community education and counseling assistance programs were the agencies' primary activities, the agencies were organized and operated for charitable and educational purposes. The court also concluded that the limited debt management services were an integral part of the agencies' counseling function, and thus charitable, but stated further that even if this were not the case, these activities were incidental to the agencies' principal functions.

Finally, the court found that the law did not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under section 501(c)(3) or to provide its services solely without charge. Nonetheless, these agencies did not charge a fee for the programs that constituted their principal activities. They charged nominal fees for services that were incidental. Moreover, even this nominal fee was waived when payment would work a financial hardship.

In *Easter House v. U.S.*, 12 Ct. Cl. 476 (1987), *aff'd* 846 F.2d 78 (Fed. Cir 1988), the court found that adoption services were the primary activity of the organization. In deciding that the organization conducted adoption services for a business purpose rather for a charitable purpose, the court considered that manner in which the organization operated. The record established a number of factors that characterize a commercial activity and which were evident in the operations of Easter House also. The court determined that the organization competed with other commercial organizations providing similar services; fees were the only source of revenue; it accumulated very substantial profits, because it set its fees in order to generate a profit; the accumulated capital was substantially greater than the amounts spent on charitable and educational activity; and the organization did not solicit and did not plan to solicit contributions. The court also found a corporate-type structure in the classes of memberships (including a single life member having inherent power that the holder could transfer like stock), and dependence on paid employees.

In *International Postgraduate Medical Foundation v. Commissioner*, T.C. Memo 1989-36, (January, 1989) the court found an organization that ran tours aimed at doctors and their families was operated to benefit the private interests of both an individual who controlled the organization and a for-profit travel agency (H&C Tours) that handled all of its tour arrangements.

The organization used the H&C Tours exclusively for all travel arrangements. There was no evidence that the organization solicited competitive bids from any travel agency for travel arrangements for its tours other than H&C Tours. The organization physically located its office within the offices of H&C Tours, which provided it secretarial, clerical, and administrative personnel for a fee equal to H&C Tours' costs. The organization spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The brochures emphasized the sightseeing and recreational component of the tours, but did not

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describe the medical curriculum for the seminars and symposia that was the basis for exemption. Educational activities occurred on less than one-half of the days on a typical tour.

The court found that a substantial purpose of the organization's operations was to increase the income of H&C Tours. The president of H&C Tours controlled the organization and exercised that control for the benefit of H&C Tours. Moreover, the administrative record supported the finding that the organization was formed to obtain customers for H&C Tours.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court concluded that an alleged exempt organization was operated for a substantial non-exempt purpose. It based this conclusion on the manner in which the organization conducted the operation of its conference center. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia*, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations." Thus, the court looked at the business methods of the organization as a way to infer whether its purpose was to serve the public or whether there was a substantial non-exempt purpose of operating a business for profit. See section 1.501(c)(3)-1(e), of the regulations.

The court determined that, if private individuals or for-profit entities have either formal or effective control of a non-profit organization, it is presumed that the organization furthers the profit-seeking motivations of those private individuals or entities. This is the case, even when the organization is a partnership between a non-profit and a for-profit entity. (citing Redlands Surgical Services v. Commissioner, 113 T.C. 47 (1999)).

The Credit Repair Organizations Act (CROA), 15 U.S.C. § 1679 *et seq.*, effective April 1, 1997, imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. § 1679b. Significantly, section 501(c)(3) organizations are excluded from regulation under the CROA.

The CROA defines a credit repair organization as:

(A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—

(i) improving any consumer's credit record, credit history, or credit rating,
or

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(ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. § 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re National Credit Management Group, LLC, 21 F. Supp. 2d 424, 458 (N.D.N.J. 1998).

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission. 16 C.F.R. § 310.4(b)(1)(iii)(B); 47 C.F.R. § 64.1200(c)(2). Section 501(c)(3) organizations are not subject to this rule against cold-calling. Because 501(c)(3) organizations are exempt from regulation under the CROA and the cold-calling restrictions, organizations that are involved in credit repair have added incentives to be recognized as section 501(c)(3) organizations even if they do not intend to operate primarily for exempt purposes.

GOVERNMENT'S POSITION

Based on the examination conducted, it has been concluded that ORG does not continue to qualify for tax-exempt status as an organization described in section 501(c)(3) of the Code. ORG does not operate exclusively for section 501(c)(3) purposes, rather it has a substantial non-exempt purpose. ORG's primary activity consists of providing DMP services and such services are in furtherance of a substantial non-exempt purpose. Our conclusion is based on the totality of factors that are noted above and discussed below.

What ORG deems to be credit counseling activities are primarily DMP enrollment activities. The counseling session notes obtained did not contain any details of a critical analysis of the caller's budget or counseling provided. Client files maintained by ORG contain only correspondence, forms, transactional and other data relating to the client's DMP account. Additionally, the primary counselor did not have the educational background or formal training to enable her to provide educational counseling to clients on personal money management.

The material posted on ORG's website is both very general and inspirational, or promotes its debt management plan (DMP). It does not provide readers with useful information about credit-related topics, such as how credit is established or impaired, how credit reports are maintained, or how individuals can protect or improve their credit through budgeting, financial planning, and other conscientious measures. It does not help individuals or the public at large to enhance their knowledge or improve their skills. Under the applicable legal standards, the content of the web site does not qualify as public education.

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ORG is similar to the organization in *CO-7* that the court concluded that a significant non-exempt commercial purpose. In that case the organization sold periodicals and provided services to individuals relating to the purchase of securities. ORG is providing services to individuals relating to the repayment of their debts. Like the organization in *CO-7*, ORG is providing services to individuals for a fee. While ORG may provide some educational services, the manner in which it operates is indicative of a business, rather than an organization described in section 501(c)(3) of the Code.

ORG is not like the organization in *CO-8*. The *CO-8* is an umbrella organization made up of numerous credit counseling service agencies. In that case, the agencies:

- Provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit;
- Provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families;
- Did not limit these services to low-income individuals and families, but they did provide such services free of charge;
- As an adjunct to the counseling function, they offered a debt management plan. Approximately 12 percent of a professional counselor's time was applied to the debt management plan as opposed to education; and
- Received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the *CO-9*. An incidental amount of their revenue was from service fees.

During the year under examination ORG provided limited information for educational seminars and outreach activities conducted.

While ORG does provide some educational activities, they are incidental when weighed against its DMP services. As provided in *Better Business Bureau of Washington D.C., Inc.* the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

The reason ORG is organized as an exempt organization is to avoid the regulatory scheme of the Credit Repair Organizations Act (CROA), 15 U.S.C. section 1679, et.seq. CROA was enacted to protect consumers by banning certain deceptive practices in the credit counseling industry. If ORG was a for-profit company, the CROA would prohibit it from charging fees in advance of

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fully providing services. In addition, if ORG were for-profit, federal law would prohibit it from purchasing leads, similar to its agreements with the two profit entities to acquire DMP clients. Because section 501(c)(3) organizations are exempted from the provisions of CROA, ORG is able to engage in deceptive business practices that Congress intended to prohibit when it passed the CROA law. As such, ORG is operated for a substantial non-exempt purpose that of carrying on a business while avoiding federal regulation. In addition, ORG could not collect "fair share" payments from creditors if it did not have exempt status. The entire DMP business depends on an organization having tax-exempt status.

Substantially all of ORG's activities revolve around its DMP operations. In describing its primary purpose and program achievements in its Form 990 return for the examination year, ORG stated that it provided consumer credit and budget counseling, and established plans for families and individuals wherein fixed partial payments were remitted to their creditors. What ORG deems to be credit and budget counseling is merely a process to determine if potential clients qualify for a DMP; and can afford the monthly payments required of a DMP. Except for an insignificant amount of receipts, all of ORG's income is derived from DMP-related activities. ORG's books and records indicate that it received \$ in grants for the examination year. However, based on the documents reviewed by the Examining Agent, it appears that the grants received by ORG are payments for collection services and credit checks it performed for other entities.

The facts in ORG's case also show that its activities serve to promote the private business interest of CO-1, rather than to promote the public interest. ORG's agreement with CO-1 allows it to perform all services related to its debt management program other than intake and counseling services. Under the agreement, CO-1 has the authority to prepare, present, and negotiate with creditors on behalf of all clients, once they are enrolled in a DMP. The agreement also authorizes CO-1 to solicit and distribute fair share payment from creditors to you. Thus, as in *est of Hawaii*, 71 T.C. 1067 (1979), certain aspects of your business operation are controlled to a certain extent by a for-profit company. The essence of the agreement with CO-1 allows it to dictate charges and methods of operation, and assures long-term financial support for CO-1. For example, if the agreement with CO-1 should be terminated, CO-1 will have the option to continue servicing existing customers, at the established fees. Moreover, the agreement gives CO-1 full access to one or more accounts for deposit of payments from clients and disbursement of payments to creditors.

TAXPAYER'S POSITION

Based on a letter faxed May 5, 20XX, taxpayer stated the following:

Please be aware of the fact that even though CO-1 is a For-Profit Company it is **not** a budget or financial consulting or planning agency or a debt consolidation agency of interest for a non-profit agency. It is an Electronic Transfer Agency for individual Counseling Agency's such as ours that are in need of Electronic proposal, electronic payment receipts and disbursement transfer

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services. This agency is on par with CO-10 and CO-11 both for-profit Agencies that service the same industry without conflict of interest queries.

By contracting CO-1 to perform these services for our agency it has allowed us to reduce our office personnel by two people and eliminate the need to dedicate one computer to the needs of constant electronic transfers, account updates, and creditor updates that are required on a daily basis. It allows us to better service our existing clients accounts and to dedicate more of our time to our financial literary programs. It also eliminated the cost and time involved for data backup, program updating and primary computer maintenance which we could no longer afford to maintain. I ask you to please rethink the fact that our contracting CO-1 is considered by you to be a conflict of interest for monetary gain and to research that matter further.

I also question why our DMP enrollment parameters is considered to be excessive. A 42% DMP counseling rate and a 23% DMP enrollment rate does not project our Agency to be a "Mill" only interested in client DMP enrollment and not educational support for involved consumers. I ask that you please reconsider you thoughts on this matter.

CONCLUSION

In summary, ORG is not operated exclusively for exempt purposes, because it does not engage primarily in activities that accomplish an exempt purpose. More than an insubstantial part of ORG's activities are in furtherance of non-exempt purposes that are commercial in nature. ORG is operated for the purpose of serving a private benefit rather than public interests.

It is recommended that ORG's tax-exempt status be revoked effective July 1, 20XX.