TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Date: 10/20/2006
Release Number: **200642010**
Date: July 27, 2006

Contact Person:

Identification Number:

UIL: 501.00-00

Contact Number:

Employer Identification Number:

Form Required To Be Filed:
Yes
Tax Years:
All

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose,* and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: June 19, 2006

Contact Person:

Identification Number:

Contact Number:

FAX Number:

UIL: 501.00-00

Employer Identification Number:

Legend:

B=
C=
D=
E=
F=
G =
H =
I =
J =
K =
L=
M=
N=
O=
P =
Website A =
Website B =
Website C =
Website D =
Website E =
Email Address A =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a) 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.

FACTS

Founding and Governance

You were incorporated as L in and changed your name to M by amending your Articles of Incorporation later that year. In your Form 1023, Application for Recognition of Exemption (hereinafter "Application"), you state that you were formed and have "conducted business operations as a defacto nonprofit corporation since ." Your founders are B and C.

According to your Application, in 2004 your officers and directors were: B (President and a Director), C (Treasurer and a Director), D (Secretary and a Director), E (a Director), and F (Chief Operating Officer and a Director).

In your January 19, 2005 letter,[1] you no longer list C as a Board member. You list B as Treasurer. Your letter of February 24, 2006 describes subsequent changes among your officers and directors. You state: B was President, CEO, and Chairman of the Board from October 2003 until September 2005; G was President and CEO from October 2005 until present; D was a Director from October 2003 until September 2004; F was Director of Education and Manager of Customer Service from July 2004 to August 2005; and H has been Secretary, Treasurer, and a Director from October 2005 until present.

The resumes you provided show the following job experiences of your founders and directors: B worked in sales, marketing, and credit education and restoration. C was a professional football player, football coach, and had opened two restaurants. E worked for a number of companies in management and sales development. G was a real estate investor and financial planner. F worked in debt settlement negotiation, financial counseling and education, money management and credit counseling. D was in the Air Force as a medical technician and worked as a registered nurse.

Purposes

Your Articles state that you are a nonprofit public benefit corporation organized for charitable purposes and not organized for the private gain of any person. Your specific purpose "is to build community and public interest and awareness in debt and finance education and solutions." Your articles further state that upon dissolution of the corporation, all remaining assets after payment of debts and liabilities shall be distributed to a nonprofit fund, foundation, or corporation which is organized and operated exclusively for charitable purposes under §501(c)(3) of the Internal Revenue Code.

Your purpose, as represented in your Bylaws, is "to educate and instruct the general public about credit, the scoring of credit reports and the remediation of erroneous credit reports." Your Application stated: "M is organized as a credit education credit improvement organization for the purpose of instructing clients in four important areas of credit education useful to individual clients and beneficial to the general public." Your purposes also include removing

[1] The letter lists January 19, 2004 as the date, but was received January 24, 2005 by our office. The letter is cited as January 19, 2005.

errors from a client's credit report, to improve client credit scores and relieve them of the mental distress caused by "sloppy credit bureau practices."

Activities

Your Application states that you instruct clients in a number of credit education topics and improve their credit scores by removing errors from their credit reports. You do not limit your services to specific individuals or classes of individuals.

Your Application states further that clients will receive four credit education modules, covering the following topics: (1) Understanding Your Credit Score, (2) Budget Planning & Basic Money Management, (3) Restoring Your Good Credit & the Wise Use of Credit, (4) Home & Auto Buying, and (5) Teens and Credit-What's Up With Your Money? You email the volumes to your clients and encourage them to study the educational materials at their own pace. Your Application also states you will create a web site, which will offer the educational materials online. The website will have information on credit reports, credit scores, payment history, credit statistics and credit support. Your Application's proposed budgets for 2004, 2005, and 2006, shows that 00.15%, 00.30%, 00.27% of your total revenue will be used for education and training seminars in each respective year.

Your letter of January 19, 2005 states that clients contacting your organization are referred to your website for information and, if interested in proceeding, complete a client application. Upon receipt of the application and payment, you take the following steps: (1) Payment and contract information are processed (If payment is by eCheck, the paperwork is held until check clears); (2) A "Tri-Merge credit report" is pulled; (3) A "Customer Service" employee makes a welcome call, and asks the client questions regarding expectations, credit report concerns and address changes. The client's address is verified and he is informed he will receive credit education materials via email; or mail every 3 months (4) The file goes to a processor, who will do the first dispute letter; (5) Dispute letters are mailed to the appropriate credit bureau; and (6) the client receives updates from the credit bureaus.

The "Welcome Letter" attached to your January 19, 2005 letter states: "Upon receipt of your Client Agreement and verification of your payment, M will begin the credit repair process."

You stated you have no formal criteria for individuals to qualify for your services, but that your services generally are sought by persons denied credit or subject to egregious credit terms. You also stated that the customer service representative initially spends 20 minutes on the phone with applicants, explaining the credit services to be rendered and the scope of credit education available. You also stated you had no formal training materials; training is done in a group setting by F.

Your letter of February 24, 2006 states that the first stage in the education process is the initial contact by an "M Affiliate." Affiliates are "independent representatives" that assist you in the promotion and sale of your services for a percentage of the fee. The Affiliate reviews the prospective client's credit needs and examines his understanding of financial literacy topics. You indicate further that the Affiliate explains your benefits, services, and financial literacy education program and takes the following steps: (1) welcome call and educational material sent to client; (3) setup client's file in the your database; (4) first dispute cycle; (5) additional dispute cycle; (6) weekly educational conference call; (7) additional education material sent to clients

and seminars; (8) unlimited access to customer service and processing; (9) unlimited e-mail support and answers to questions; and (10) certificate of completion.

Your February 24, 2006 letter states that clients are invited to participate in regularly scheduled national conference calls. You also plan to: (i) "conduct and host live face-to-face seminars and financial workshops" on a monthly basis; (ii) create a "continuing education" series that includes an "opportunity for its associates, investors and business owners to attend financial seminars and workshops to further their knowledge and awareness of new financial products, investment tools and personal development programs"; and (iii) expand your "education" program to colleges and universities, people filing for bankruptcy, parolees, real estate agents and senior high school students.

Your February 24, 2006 letter states you offer a free 2-hour Business Briefing. The Business Briefings are overviews which outline ways for your members to pool resources and "take advantage" of your "unique training and support system." The material your submitted states in part:

> Studies showed that investors have a great interest in having access to systems that streamline the investing process and give them the upper hand in the marketplace. We believe we have what investors want and today anyone can join our ***Power Team*** of business professionals and participate in a variety of investor clubs and/or mastermind groups to assist them in finding and funding good real estate, stock and business deals.

The promotional language says that clients must pay for the 1-day seminars, 2-day workshops, and 3-day boot-camps that you offer. Each course has a "money back guarantee." You market the courses as an opportunity for your "associates, investors and business owners" to gain knowledge of "new financial products, investment tools and personal development programs."

You state that your clients are invited to participate in national conference calls conducted by B part of your educational program. None of your websites or material offered to potential clients, including the enrollment contract, mentions the availability of national conference calls for client participation.

Ownership of N

Your Application stated that B and C each owned 41% of N, D owned 3%, and several other investors owned 15%. Your Application further stated that I was President and CEO of N.

Your January 19, 2005 letter stated that B owns 25% of N, D owns 3%, and other investors 72%. Your February 24, 2006 letter stated that B is a 50% holder of the issued and outstanding shares of N. In addition, you attached to your February 24, 2006 letter a letter to you from N dated February 22, 2006. The letter from N states, under past ownership, that C owned 75% of N and B owned 25%. Under present ownership, it states that C and I each own 50% of N. N's letter also states that B is the only person who has been associated with both you and N.

In your letter dated March 8, 2006, you indicated that an error was discovered in your February 24, 2006 letter. You stated therein that B owns 25% of the shares of N. By letter

dated March 22, 2006, you advised us of other errors in your February 24, 2006 letter with respect to the ownership of N. You attached a letter from N dated March 21, 2006. It states, under past ownership that: B owned 25% of N from October 2003 to present; C owned 75% from October 2003 to June 2004. Under present ownership, the letter from N states, from June 2004 to present C owns 50% of N, I owns 25% and B owns 25%.

Officers and Directors of N

Your Application stated that I was President and CEO of N. Your January 19, 2005 letter stated that none of the owners of N (other than B and D) are directors or employees of you. You also represented that J is the current manager, President, and CEO of N.

Your letter of February 24, 2006 stated that I was President and a Director of N from October 2003 until December 2004, then became Secretary, Treasurer, and a Director from January 2005 until present. It also stated that C was the Secretary, Treasurer, and a Director of N from October 2003 until December 2004. K acted as president of N from January 2005 to October 2005. C was president from November 2005 until present. The letter also states that B is CEO and a Director of N.

In your letter dated March 22, 2006, you advised us of errors in your February 24, 2006 letter with respect to the officers of N. You attached a letter from N dated March 21, 2006. For past officers, it states: I was president from October 2003 to January 2005; K was President from January 2005 to November 2005; and B was Secretary/Treasurer from October 2003 to January 2005. For present officers, it states: B was President from November 2005 to present; and I was Secretary/Treasurer from January 2005 to present.

Agreements with N

Your Application states that you and N entered into an oral marketing and sales agreement on January 8, 2004 "for the purpose of marketing and selling the credit education/credit improvement services offered by [you]." Your Application also states that, on August 16, 2004, you and N "entered into a new written agreement which provides N with an initial exclusive 3-year marketing, sales and advertising agreement." Your Application did not contain a copy of the written agreement.

Your January 19, 2005 letter includes a copy of a marketing and sales agreement between you and N dated January 10, 2005. The agreement states that it is nonexclusive and you will compensate N by paying a commission of 80% of the gross sales revenue generated by N's activities. It is signed by B, as your President and J as President and CEO of N.

Your February 24, 2006 letter includes a copy of a marketing and sales agreement between you and N dated September 27, 2004. The agreement states that it is nonexclusive and that you will compensate N by paying a commission of 20% of the gross sales revenue generated by N's activities. This agreement is signed by B as your President I as President of N.

In your Application, the proposed financial data for 2004, 2005 and 2006 respectively shows payments of $1,226,114, $1,471,000, and $1,618,000 to N for marketing services. The proposed budget in your Application for 2004, 2005 and 2006 shows $1,628,476, $2,006,000,

and $2,199,000 in revenue for each of those respective years. Thus, for each respective year, approximately 75.00%, 73.00%, and 74.00% of your total revenue was projected to be paid to N for marketing and sales.

Your website, Website A, (under "About Us," "The Company") states that N serves as your "marketing arm" and that you and N are in a joint venture partnership. A copy of the website, dated May 23, 2006, is attached. Under "Products and Services," the website states: "When [N] entered into a joint venture partnership with [M] it began marketing both the credit correction system and the credit education programs[.]"

Under "Partnerships," this website states:

> [N] has formed a marketing alliance with [M] which is the actual processor of the credit correction and education system. Through this alliance, [N] is able to use its marketing abilities and sales force to introduce customers to [M's] credit correction and education services. . . [N] has pooled resources and developed dynamic relationships with premier marketing organizations and sales forces across the country and is able to continue its focus on innovative sales and marketing strategies.

Your February 24, 2006 letter states that N will cease to function on or before March 31, 2006. As of June 1, 2006, the Secretary of State listed N as an active corporation.

Business Address

Your Application states that you occupy office space adjacent to, but separate from, office space occupied by N, and that N expects to move to a separate building within a few months. Your lease, real estate appraisal, client agreements, and welcome letter contain the same address for you and N. The real estate appraisal submitted with your letter of January 19, 2005, assessed the rental value of this entire property. Both you and N used this address on the marketing agreement dated January 10, 2005.

The lease submitted with your Application states that you "shall occupy 2,000 square feet of the Southern ½ of the premises." The lease grants you the right to install an identification sign on the building's monument sign. The agreement between you and N dated September 27, 2004 (submitted with your February 24, 2006 letter), lists your address as Suite A and N's as Suite B. The phone number both you and N list on your agreements, training materials, educational volumes and websites is the same.

Website

Your January 19, 2005 letter states your website address is Website B.

Under "Virtual Business Center," the "N Associate Training Handbook" you submitted with your January 19, 2005 letter ("N Handbook") lists "[o]ur demo sites" as Website C and Website B. The N Handbook tells Associates that they may get into "my back office" on these sites. Each of the websites , Websites A, B, C, D and E list you as the sites' sponsoring organization and contain the same general information and contact information about you (address and telephone number). (See attached.) The N Handbook contains a model letter with your letterhead (to be sent to clients) that lists the customer service email as: Email Address A.

The N Handbook also contains pages with blank business card forms for use by Associates; the blank cards list on the bottom your Website Address/your name. Websites B, C, and E present ways to recruit potential employees, i.e., "Associates," and to attract potential clients. All of the Websites have links to "my back office."

Your February 24, 2006 letter states: "[M] does not now, nor has it ever owned or controlled the referenced website [Website B]." Your letter also states: "N informs [M] that it does not now nor has it ever owned the referenced website [Website E]" Your February 24, 2006 letter identifies Website A as your website.

As of May 30, 2006, Websites B and E are active and operating web sites, as are Website A (last checked, May 23, 2006), Website D and Website C (last checked, June 1, 2006).

Clients

Your January 19, 2005 letter states that you enrolled approximately 7,000 clients between October 2003 and September 2004. Of these clients, 3,500 were still engaged in the process. Your Website A states that you have helped "tens-of-thousands of Americans." It also states that, since 2003, both you and N have "successfully assisted over 15,000 clients remove incorrect and inaccurate items from their credit reports." The N Handbook states that you and N serviced 8,000 Americans in the first year of operation.

Fees

Your Application lists the following fees for your services: credit reports, $30.00; and credit education and improvement services, $499. Your January 19, 2005 letter contained the following fee schedule: $499, plus $30 for one credit report; and, for two clients, $750, plus $60 for two credit reports. Your letter of February 24, 2006 states that the price for one year of financial literary education and credit correction services is $499. Websites B, C, and E, state that the basic plan costs $499 (+$30 for 1 credit report), and a Two for One plan costs $750 (+$60 for 2 credit reports).

Your application stated the fee will be refunded or waived if a client's credit score has not been improved by the deletion of erroneous information, or if the client can't pay the fee because of a lack of financial resources. It also stated that you provided free credit improvement services to as many as 1,000 individuals who were unable to pay. You said these individuals had paid fees to other companies for credit improvement but had received no services. You did not identify these companies.

Your February 24, 2006 letter stated that, for those earning less than $25,000 a year or who are active military, the education and correction fee is $275. It also said that you would provide the education and correction services for free to individuals with financial hardship, victims of identify theft, and individuals referred to you by another non-profit organization. It also stated that approximately 25% of your clients receive free services.

There is no mention in the N Handbook, your client agreements, your welcome letter or your websites regarding the availability of free or reduced-cost services.

Your February 24, 2006 letter discusses making your services available to a local nonprofit organization that provides housing and services to individuals to enable them to find permanent housing and income. It also states: "At times [M] has provide [sic] free assistance, education, support and training to help provide and establish a new foundation from which each participate [sic] of the [Project] can launch their new life and career."

Marketing and Associates

Your January 19, 2005 letter stated: "The organization has no present plans to advertise its products and services by means of TV ads, Internet ads or ads in the print media."

Your February 24, 2006 letter describes workshops that come with a "money back guarantee," and that all of your clients are given a "100% money back guarantee if we are unable to expand their financial literacy awareness or improve their credit profile."

According to Website B and D, N has enlisted the services of "independent representatives" to assist in the promotion and sale of your services. These representatives receive a percentage of each plan sold. Representatives receive higher fees as they recruit additional representatives. They also receive a percentage of the sales fees earned by new representatives. These new representatives are charged a website set-up fee of $19.95 and $24.95 per month billed in arrears.

The N Handbook primarily addresses sales and marketing, with topics including "Lifecycle of a New Client Programs" and "Business Opportunity." Under "Compensation Plan," the N Handbook explains how associates are rewarded for recruiting more associates and clients. An associate takes 25% of every $499 plan sold and a percentage commission from the sales of associates recruited.

Under "Power of Networking Marketing," the N Handbook describes this compensation arrangement as a "business opportunity" for its associates:

> Everyone you meet is a prospective Independent Associate, because the cost to become involved is relatively low and no experience is required. Everyone who becomes part of the Network can expand business, so the potential for growth and profitability is unlimited. A modern Network Marketing business requires none of the risks, headaches, problems or limitations associated with "business as usual."

Your letter of February 24, 2006 states that you now operate the Associates program.

Other Agreements

Your Application described a partnership with a Bank to operate a program called "Get Checking." The program consisted of your clients gaining a certificate of completion upon finishing your education modules. With the certificate, the client could open an account with the

Bank, which would also donate funds to support the educational programs. You did not address whether the program continues to exist, any client referrals were made, or any payments were made by the bank or fees received from the program.

Your letter of February 24, 2006 states that you have entered into an agreement with O. O is "the exclusive licensing agent of certain software technology relating to the transfer of consumer payment and personal information to third party databases." The contract states that O "desires to have the software technology commercialized to benefit the public," and is granting a use right to you. The service allows your associates to have "their on time monthly bill payments (cell phone bills, utilities, rent payments, etc) reported to the national credit bureaus." Under the agreement, you and O will each receive 50% of a fee ($4.95) charged to your clients to have their "on-time monthly bills (all rent, phone, utilities, etc.) reported to the national credit bureaus which in turn has a positive impact on an individual's credit profile." The contract also states:

> [It] is expected that the technology will be diligently exploited by [M] to increase [O] technology utilization in the marketplace and with that expectation, after technology is successfully tested and implemented, [M] agrees to diligently market the service technology (product) as a part of its product offering or to third parties which may utilize the technology (under separate agreement with O as may be negotiated).

Public Support

Your Application states that your revenue will come from fees for services. Your letter of April 1, 2005 states that you will solicit contributions from foundations, community businesses, and private individuals. You did not submit information about actual solicitations or receipt of public donations.

Compliance with State Laws

In your letter dated February 24, 2006, you responded to our question about what type of registration, permit or license you have with the State:

> [M] has always considered itself to be a section 501(c)(3) organization and further compliance with state law is not required. [M] respectfully submits that the IRS lacks jurisdiction to inquire about [M's] compliance with the State … Civil Code. "

Under "Frequently Asked Questions--Is the [M] Credit Correction Program Legal?" your website, Website A states:

> We strictly follow the Fair Credit Reporting Act, as well as state and federal laws. We are fully licensed as a credit service organization. We are a member of the Better Business Bureau, registered with consumer affairs and listed on Dun & Bradstreet.

Class Action Lawsuit

Your predecessor organization, L, P, and B are defendants in a class action lawsuit filed in the United States District Court on February 26, 2004. The suit alleges violations of the Credit Repair Organizations Act. On May 21, 2004, the court granted an initial 90-day stay on all proceedings, renewed until January 13, 2005. Your January 19, 2005 letter stated that it was the view of Defendants' trial counsel that the suit would be dismissed upon our recognition of you as exempt under section 501(c)(3) of the Code. You have submitted no evidence that the law suit has been dismissed.

LAW

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

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to exempt as an organization described in section 501(c)(3), and 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 or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

(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 that 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 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 to 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 interests, 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)(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.

In Rev. Rul. 65-299, 1965-2 C.B. 165, the Service recognized a credit counseling agency open to the general public as exempt under section 501(c)(4) of the Code. The agency was incorporated as a nonprofit corporation to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. The Service found that the objective and activities of the agency contributed to the betterment of the community as a whole. The agency did not limit its services to the poor.

The agency employed specialists to interview applicants who were in financial difficulty, analyze the specific problems involved, and counsel on debt repayment. With creditors' consent, it set up monthly repayment plans and made monthly pro rata distributions to creditors. It made no loans to the applicants nor negotiated loans on their behalf. It charged nominal fees for monthly prorating services, but charged no fees for counseling. The organization relied upon contributions from local businesses, lending agencies, and labor unions to cover its costs.

In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service found that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code. Its board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, which held the funds in a trust account and disbursed the funds on a partial payment basis to the creditors. The organization did not charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid. The organization did not make loans to debtors or negotiate loans on their behalf. Finally, the organization relied upon voluntary contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The Service found that by aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and beneficial to the community. Thus, the organization was exempt from federal income tax under section 501(c)(3) of the Code.

Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978), held that an organization which provided information and counseling on budgeting and consumer credit was exempt under section 501(c)(3) of the Code. The

organization provided information to the general public through the use of speakers, symposia, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. It also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. The organization did not charge for these information and counseling programs. As an adjunct to its counseling programs, the organization developed and implemented debt management programs. The debt management activities accounted for approximately 12 percent of the professional counselors' time. The organization charged a nominal fee of up to $10 per month for them, which was waived for financial hardship. The organization received financial support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way.

The court held that the community education and counseling assistance programs were charitable because they advanced education and promoted social welfare. It concluded the debt management and creditor intercession activities were "an integral part" of the agency's counseling function, and thus were charitable and educational. Alternatively, these activities were incidental to the agency's principal functions. See also Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979) (virtually identical facts).

Rev. Rul. 78-99, 1978-1 C.B. 152, held that the provision of individual and group counseling for widows based on their ability to pay is an educational activity.

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 purposes, 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 B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial.

In addition, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

The Court in est of Hawaii v. Commissioner, 71 T.C. 1067 (March 28, 1979) found that an organization formed to educate people in Hawaii in the theory and practice of "est" was a part of a "franchise system which is operated for private benefit," and therefore may not be recognized as exempt under section 501(c)(3) of the Code. The applicant for exempt status was not formally controlled by the same individuals controlling the for-profit organization owning the license to the est body of knowledge, publications, methods, etc. However, the for-profit exerted "considerable control" over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The

court found that the fact that the applicant's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit corporations were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether it benefited substantially from the operation of the applicant. The court determined that there was a substantial private benefit because the applicant "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations.

In P.L.L. Scholarship v. Commissioner, 82 T.C. (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The board was self-perpetuating. The court reasoned that, because the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The court was not persuaded.

> A realistic look at the operations of these two entities, however, shows that the activities of the taxpayer and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accountings of receipts and disbursements do not change that fact.

The court went on to conclude that, because the record did not show that the organization was operated for exempt purposes, but rather indicates that it benefited private interests, exemption was properly denied.

In Harding Hospital, Inc. v. United States, 505 F.2d. 1068 (1974), a previously for-profit hospital amended its articles of incorporation to gain tax exempt status. It retained its previous contract with a for profit medical partnership composed of seven doctors, the Associates, who performed all the treatments on 90% to 95% of the hospital patients. The hospital entered into contracts with the Associates whereby the Associates provided nearly all of the hospital's services in return for significant fees and favorable leasing agreements. The majority of the Board of Trustees was comprised of individuals not connected with the Associates. The court stated that:

> The phrase "net earnings," as used in §501(c)(3), may include "more than the term net profits as shown by the books of the organization or than the difference between the gross receipts and disbursements in dollars." Northwestern Municipal Ass'n v. United States, 99 F.2d 460, 463 (8th Cir. 1938). Earnings may inure to an individual in ways other than though the distribution of dividends. 6 Mertens, Law of Income Taxation, §34.13, at 63 (1968 ed.).

The court affirmed the finding that the hospital did not qualify under §501(c)(3) because the hospital did not hold itself out as a charitable institution; did not have a specific plan or policy for the treatment of charity patients for the years in question; the doctors who treated between 90% and 95% of the hospital's patients derived substantial benefit from the hospital's operations; the Associates benefited from the favorable rental agreements and earnings for their supervision of the hospital, nursing, pharmacy, and laboratory.

In American Campaign Academy v. Commissioner, 92 T.C. at 1068 (1989), the American Campaign Academy, an outgrowth of the National Republican Campaign Committee

(NRCC), claimed no formal ties with the Republican Party (GOP). Yet the Court found that the secondary benefits conferred on the Republican Party and its candidates who employed the students were not incidental to the Academy's exempt educational purpose. Several factors showed that the Academy operated with the targeted goal of benefiting the GOP: the Academy accepted office equipment from the NRCC and exclusive funding from the National Republican Congressional Trust; two of three Academy directors held significant positions within the GOP; the general counsel to the NRCC incorporated the Academy; and the entire admissions committee consisted of people associated with the Republican Party. The Academy studied topics such as "Growth of the NRCC," and "Why Are People Republicans," but did not include similar topics with respect to other political parties. In light of these facts, the court found that the Academy "conducted its educational activities with the partisan objective of benefiting Republican candidates and entities."

In American Institute for Economic Research v. United States, 301 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analysis of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it 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 St. Louis Science Fiction Limited v. Commissioner, T.C. Memo 1985-162, April 2, 1985, the Court reviewed the annual convention of a science fiction organization. It held that while the conventions may have provided some educational benefit to some of the individuals involved, that social and recreational purposes, and private benefit predominated. The Court distinguished Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980) in which the organization provided public art education by using juries to insure artistic quality and integrity.

> Petitioner relies heavily upon Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980), in support of its contention that it is tax-exempt. In Goldsboro Art League, the taxpayer was an organization that operated two art galleries that exhibited and sold artworks. We held that the taxpayer was tax-exempt under section 501(c)(3) because it was organized and operated exclusively for an exempt purpose--art education. We noted that in order to insure artistic quality and integrity, the artworks displayed were selected by jury procedures. We also noted that the taxpayer was the only such museum or gallery within its county, or any contiguous county. We held that it served public, rather than private interests and that its sales activities were incidental to advancing its exempt purpose. By contrast, petitioner in this case did not apply any controls to insure the quality of the books and artworks sold at its convention. Also, the tone of petitioner's convention is substantially, if not predominantly, social and recreational, rather than educational. In addition, petitioner's huckster's room and art auction provided substantial benefit to private interests that is not incidental to its exempt purpose. Consequently, we think the case Goldsboro Art League is clearly distinguishable on its facts from the instant case.

In Church By Mail, Inc. v. Commissioner, T.C. Memo 1984-349, *aff'd* 765 F. 2d 1387 (9th Cir. 1985) the tax court found that a church was operated with a substantial purpose of

providing a market for an advertising and mailing company owned by the same people who controlled the church. The church argued that the contracts between the two were reasonable, but the Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'g 12 Cl. Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because it operated for a substantial commercial purpose rather than for the exempt purposes of providing educational and charitable services to unwed mothers and children. The services for unwed mothers and children were merely provided "incident" to the organization's adoption service business. The agency's operation was funded completely by the fixed fees charged adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. Moreover, the court found that "adoption services do not in and of themselves constitute an exempt purpose."

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. "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."

The Credit Repair Organizations Act ("CROA"), 15 U.S.C. section 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. section 1679b. Section 501(c)(3) organizations are by definition 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
> (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. section 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).

In FTC v. Gill, 265 F.3d 944 (9th Cir. 2001), aff'g 183 F. Supp. 2d 1171 (2001), the appellate court inferred that a credit repair organization that first promised a "free consultation," but charged fees in advance of the full performance of services was being operated as a charity primarily for purposes of evading regulation under the CROA.

Section 508 (a) of the Code provides, with certain exceptions, that an organization organized after October 9, 1969, shall not be treated as an organization described in section 501 (c)(3) unless, within the time prescribed in the regulations, it gives notice that it is applying for recognition of exempt status. Section 1.508-1 (a) (2) (i) of the regulations provides that notice must be given 15 months from the end of the month in which the organization was organized. Notice is given by submitting a properly completed and executed Form 1023, Application for Recognition of Exemption, to the appropriate key District Director. Section 1.508-1 (a) (2) (iii) provides that an organization shall be considered "organized" on the date it becomes an organization described in section 501 (c) (3) (determined without regard to section 508 (a)). Section 508 (c) and section 1.508-1 (a) (3) describe organizations such as churches, that are not subject to section 508 (a) notice requirements. Rev. Proc. 84-47 (IRB 1984) and Rev. Rul. 77-208, 1977-1 C.B. 153.

Rev. Proc. 90-27, 1990-1 C.B. 514, provides in part that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere statement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned, and the nature of the contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or determination letter will be issued.

An organization must establish through the administrative record that it is organized and operated as a section 501(c)(3) organization. Denial of exemption may be based solely upon failure to provide information describing in adequate detail how the operational test will be met. American Science Foundation v. Commissioner, T.C. Memo. 1986-556; La Verdad v. Commissioner, 82 T.C. 215, 219 (1984); Pius XII Academy v. Commissioner, T.C. Memo. 1982-97. Exempt status can be recognized in advance of operations if proposed operations can be described in enough detail to permit a conclusion that the organization will clearly meet the requirements of section 501(c)(3). American Science Foundation v. Commissioner, T.C. Memo. 1986-556. The organization has the burden of providing sufficient documentation or other substantive information regarding its activities and operations, which would establish entitlement to tax-exempt status. Information that is vague or nonspecific is not sufficient to meet the requirements under section 501(c)(3). Share v. Commisioner, T.C. Memo, 1999-216.

ANALYSIS

You have not established that you are exempt under section 501(c)(3) of the Code. You do not operate primarily in furtherance of exempt purposes. You also operate for the benefit of private interests. Finally, your net earnings inure to the benefit of private entities and individuals.

Operation for Exempt Purposes

You do not operate primarily for charitable or other exempt purposes

You have not shown that your credit repair and education activities further charitable purposes. You do not limit your services to a specific class of individuals or apply any formal criteria to determine eligibility for your services. See Rev. Rul. 69-441 (counseling and debt management activities limited to low income individuals and families with financial problems). Further, a potential client first must complete an agreement and pay $499 before receiving any of your credit repair and training services or materials. Your representations about providing free or below-cost services are inconsistent with what is presented on your websites, client agreements, welcome letters and the N Handbook. See Consumer Credit Counseling Service of Alabama (no charge for counseling and education; debt management fees waived for financial hardship); Rev. Rul. 69-441 (no fees for counseling or debt management services).

Nor have you shown that you primarily further educational purposes. Your projected budget for educational programs is incidental, 00.15%, 00.30%, and 00.27% of revenue respectively for the years 2004, 2005, and 2006. Compare Consumer Credit Counseling Service of Alabama (finding nonexempt purposes to be incidental to educational purposes). A potential client first must complete an agreement and pay $499 for your credit repair services before you send any of your instructional materials. Compare Consumer Credit Counseling Service of Alabama (debt management services were an adjunct to counseling function) with Easter House (educational services to unwed mothers were incidental to adoption services business). Your welcome letter only mentions that the credit repair process begins upon your receipt of the application and payment; it does not mention educational programs. When a paid client does receive a welcome call, your customer representative speaks to them only for 20 minutes, time just to make sure the client understands the credit repair services to be rendered and the scope of credit education available. You also stated that you have no formal training materials for your representatives. The commissions and bonuses for your (and N's) associates are tied to the number of credit repair plans they (and other associates they recruit) sell, not the level of education they provide. The material posted on your websites and the N Handbook, primarily promote the marketing and sales of your credit repair services, rather than education and counseling.[2]

Moreover, you operate for a substantial nonexempt commercial purpose. You charge up-front fees before providing any services. The N Handbook instructs representatives on selling and marketing your services to expand business opportunities and increase profitability. Associates' commissions and bonuses reward increased sales of credit repair services and recruiting more sales associates. None of your client agreements, welcome letters, web sites or the N Handbook mention free or below-cost services. You provide a money back guarantee if clients' credit scores do not improve. With respect to O, you agreed to diligently market, exploit and commercialize its software technology, and both you and O receive a fee for each client who purchases the service. You established Power Teams to help business professionals find and fund good real estate, stock and business deals. Thereby, your billing, marketing, training and

[2] While you and BLG both have disavowed your previously identified websites, these sites contain the same or similar information with respect to you and BLG and your respective activities as your current site. The previous sites also continue to be active.

compensation practices are similar to commercial entities. See Airlie Foundation (conducting activities in a commercial manner); Easter House (adoption agency operated for substantial commercial purposes); B.S.W. Group (engaging in commercial ventures). Your substantial nonexempt commercial purpose outweighs any other exempt purposes you may serve. See Better Business Bureau of Washington, D.C.

Operation for Private Benefit

You do not operate for the benefit of the general public. Instead, you operate primarily for the private benefit of N and your founders.

Your founders, B and C, always have owned between 75% and 100% of N from your formation to the present.[3] They both have served as directors and officers of you and N. C has been an officer and director of both you and N at the same time. Since formation, you only have contracted with N to sell and market your services.[4] At least one agreement was exclusive. Even though subsequent agreements were non-exclusive, you continued to use only N for sales and marketing services. Pursuant to these agreements, you have paid (or been obligated to pay) N between 73 and 80 percent of your total revenue.

Your representations also raise serious doubts about whether you and N operate as separate, independent corporations. You share the same address and phone number. Your websites, client agreements and the N Handbook do not clearly delineate your separate identities or operations.

Further, the timing of your formation, after the enactment of CROA and after the filing of the class action suit, and the fact that you were founded by the owners of N, raise serious questions about whether you were formed for the express purpose of allowing N to continue to operate much as it had prior to your formation, but without being subject to CROA or the class action claims. See FTC v. Gill. Taken together, these facts indicate that you operate for the private benefit of N and its owners. See P.L.L. Scholarship (activities of exempt and for-profit were so interrelated as to be functionally inseparable); American Campaign Academy (benefits to other organization not incidental to exempt educational purpose).

Inurement

Your net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Your founders, B and C, always have owned between 75% and 100% of N from your formation to the present. Your founders both have served as directors and officers of you and N,

[3] As noted in the statement of facts, your representations about past and present ownership of N have been inconsistent, both in terms of ownership percentage and owners (even considering your March 2006 corrections). Some of your representations with respect to officers and directors also have been inconsistent.

[4] Based on your representations, as presented in the facts, it does not appear you have provided us copies of all your agreements with N. There also are a number of inconsistencies between your representations and the terms of the agreements you have provided us.

sometimes at the same time. You have contracted solely with N to sell and market your services. You have paid (or been obligated to pay) N between 73 and 80 percent of your total revenue. You did not obtain bids from other companies or otherwise establish that the compensation under these contracts was reasonable or at arms length terms. Under these circumstances, your net earnings inure to the benefit of your founders and N. See Est of Hawaii (for-profit exerted considerable control over nonprofit, which simply was the instrument to subsidize the for-profit); Harding Hospital (non-profit hospital continued to contract with founding physicians for most patient care); Church By Mail (advertising and mailing company that was owned by the same individuals who controlled the church benefited substantially from the church's operations).

CONCLUSION

You have not established that you are exempt under section 501(c)(3) of the Code. You do not operate primarily in furtherance of exempt purposes. You have a substantial non-exempt commercial purpose. You also operate for the private benefit of BLG and its owners. Finally, your net earnings inure to the benefit of BLG and its owners.

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.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative,* if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney.* All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree 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 all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements