

Internal Revenue Service

Department of the Treasury

Number: **201202041**
Release Date: 1/13/2012

Person to Contact:
Employee ID Number:
Tel: ()
Fax: ()

Date: October 6, 2011

Refer Reply to:

UIL: 9300.99-02

Employer Identification Number:

Certified Mail

Dear _____ :

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Our favorable determination letter to you dated February 22, 20xx is hereby revoked and you are no longer exempt under section 501(a) effective July 1, 20xx.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the Clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

Our adverse determination was made for the following reason:

You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3) and Treasury Regulations section 1.501(c)(3)-1(d). You did not engage primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3). You are operated for a substantial non-exempt purpose, which is not an exempt purpose. You are operated for the benefit of private rather than public interests and your activities resulted in substantial private benefit.

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on Form 1120 for any years which are still open under the statute of limitations. Based on the information you furnished, it appears that returns should be filed beginning with the year ending June 30, 20xx. You should file any returns due for these years or later years with the Department of the Treasury, Internal Revenue Service Center, Cincinnati, OH 45999-0012 (as applicable for 1120). Processing of income tax

returns will not be delayed because you have filed a petition for a declaratory judgment under Code section 7428.

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance, or you can contact the nearest Taxpayer Advocate office by calling (312) 566-3800 or writing to Local Taxpayer Advocate, 230 S. Dearborn Street, Room 2860, Stop 1005CHI, Chicago, IL 60604. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. 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 IRC section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Sincerely,

Appeals Team Manager

cc:



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 24, 2009

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.

Letter 3618 (04-2002)
Catalog Number 34809F

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,

Sunita Lough
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 ORG (ORG)		Year/Period Ended June 30, 20XX and June 30, 20XX

LEGEND

ORG - Organization name XX - Date State - state website - website
County - county ATTN - Attorney RA-1 - 1st RA DIR-1, DIR-2, DIR-3,
DIR-4, DIR-5 & DIR-6 = 1st, 2nd, 3rd, 4th, 5th & 6th DIR CO-1 THROUGH CO-7 =
1st THROUGH 7th 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?

Whether any part of the net earnings of ORG inured to the benefit of any private shareholder or individual?

Facts

Background:

On July 21, 20XX, ORG filed original articles of incorporation with the State Secretary of State. The articles of incorporation provided that its purpose was "to assist our local community in providing a safe meeting place, positive social environment, and transition into a drug free workplace, for the youth between the ages of twelve and eighteen.

The following individuals were listed as ORG's directors:

- DIR-1
- DIR-2
- DIR-3
- DIR-4

On October 5, 20XX, ORG filed articles of dissolution with the State Secretary of State effective October 4, 20XX. The articles of dissolution were signed by the president/director, DIR-4.

On February 1, 20XX, ORG filed articles of revocation of dissolution effective January 30, 20XX. The revocation of dissolution was signed by DIR-3

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On November 8, 20XX, ORG filed an amendment to the articles of incorporation changing Article III – Purpose to “organized exclusively for religious, charitable, scientific, literary, and educational within the meaning of section 501(c)(3) of the Internal Revenue Code.”

ORG subsequently filed two amendments on March 30, 20XX and April 8, 20XX changing its name to ORG and ORG, respectively. Both amendments were signed by directors, DIR-5 and DIR-6.

Form 1023 Application:

On October 22, 20XX, ORG filed a Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, with the Internal Revenue Service, hereinafter “IRS” or the “Service”. As indicated above, ORG would later become ORG

ORG stated it the following in its 1023:

Planned Activities – The organization was formed to educate debtors, consumers and the general public with respect to financial obligations and potential problems which may arise from use of credit card financing and other debt.

- (1) Primary activity will consist of a debt assistance service which is designed to alleviate onerous interest rates and/or financing costs charged by some creditors to consumers. This activity will allow the organization to assist such consumers with their financial obligations. At the same time that these consumers engage the above-described services, educational information will be supplied so that the consumer may be apprised of how to avoid certain financial pitfalls.
- (2) Secondary activity will consist of a multimedia campaign to increase general public awareness.

The activity will be initiated on or around July 20, 20XX and will be conducted at the corporate offices, primarily by and through the corporate directors.

The organization’s primary (80-95%) source of financial support will consist of contributions from business organizations which deal with consumers who engage the filing organization’s services. The remaining source of financial support will consist of private contributions.

In a letter dated February 22, 20XX, ORG was recognized by the 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:

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During the examination years, June 30, 20XX and 20XX, on its Form 990 returns, ORG has described its primary purpose and program achievements as follows:

20XX06

Primary Exempt Purpose: To provide education to the public on the proper use of credit cards and debit cards. Provide debt management training programs to the public.	Program Service Expenses
Exempt Purpose Achievements	
a. ORG provides debt management assistance which is designed to alleviate the onerous interest rates and/or financing costs charged by credit card companies	\$
b. Educate consumers on the use and misuse of credit cards	

20XX06

Primary Exempt Purpose: To provide education to the public on the proper use of credit cards and debit cards. Provide debt management training programs to the public.	Program Service Expenses
Exempt Purpose Achievements	
a. ORG provides debt management assistance which is designed to alleviate the onerous interest rates and/or financing costs charged by credit card companies	\$
b. Educate consumers on the use and misuse of credit cards	

ORG provides its credit counseling services primarily by telephone. ORG has three full-time counselors. ORG obtains clients directly from its website and through the purchase of leads. ORG paid \$ per lead during the years under examination and there were no written contracts.

During the examination years ORG counselors were provided a script that was to be utilized during credit counseling sessions. The script focused on enrolling callers into a DMP. The script was used to collect information necessary to determine if the client has enough disposable income to enter into DMP. The script aimed at assessing the callers' debt situation, explaining how a DMP works, explaining the benefits of a DMP, presenting ORG as a credible organization, and starting the DMP enrollment process. **(See Exhibit #1 for complete script.)**

When placing the client on a Debt Management Program, the first thing the counselor must do is identify the root cause of the current financial situation. At this point, a determination would be made if enrollment in a DMP would alleviate the financial burden. This does not happen in every case.

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Also, the counselor must determine if the client's budget can meet the creditor's criteria for payment or if another option would be better suited for the client.

If client does not have a positive cash flow of \$/month of discretionary income after budget calculations, we will not enroll in DMP. Client must be able to afford payments and have discretionary funds available after the payment is factored into budget.

Once ORG enrolls clients into its DMP program, their file is transferred to CO-1, a for-profit service provider, for processing. CO-1 verifies the clients' debt, negotiates contracts and credit proposals, in addition too, collecting and disbursing client payments. ORG transfers the signed paperwork from client electronically and through fax. Upon transfer of the account to CO-1, ORG maintains the documents for six months before they are shredded. A client can contact ORG at anytime during the program to assist them with additional education and counseling.

EO Agent reviewed a sample service agreement provided by ORG. The agreement is between ATTN (Attorneys), the Attorneys' affiliate, ORG, a non-profit organization that provides educational services related to debt management and credit counseling and the client. The agreement states in part, "Attorneys and ORG agree to provide budget, educational and counseling services to Client, and to evaluate Client's debt status, including Client's available and projected income and the existence of other liquid assets as well as the Client's indebtedness to determine if it is in the best economic interest of the Client to enter into a monthly debt repayment plan with Client's creditors which results in reduced interest and/or payments to creditors that participate in the plan (the "Debt Management Plan" or "Program")."

The service agreement also states there will be an initial fee used to cover legal and operational costs involved in setting up and negotiating the accounts with Client's creditors, and thereafter there is a monthly Program maintenance fee of \$ which shall commence with the second monthly payment. The service agreement also includes a debt work sheet, EFT bank account enrollment form, and monthly budget form. **(See Exhibit #2 for complete service agreement.)**

During the years ended June 30, 20XX and 20XX, ORG's income was generated from CO-3, CO-2, CO-4 withheld, CO-4 billed, and program fees. As evidenced below with the exception of interest income, all of ORG's income is generated from DMP activities.

Per Books – June 30, 20XX		Per Books – June 30, 20XX	
CO-2 - CO-1		CO-4 Billed - CO-1	
CO-3 - CO-1		CO-4 Withheld - CO-1	
CO-4 Withheld - CO-1		CO-2 - CO-1	
CO-4 Billed - CO-1		Program Fees	

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Program Fees			CO-3 - CO-1		
Interest Income			Electronic Form Fees		
			CO-3 - CO-1		
			Electronic Form Fees		
Total			Total		

Educational Activities:

ORG's educational activities consist of conducting weekly radio talk show on CO-5, holding public forums at different venues, distributing educational texts, and maintaining a website.

ORG's website is located at website. The welcome page states that ORG works with approved debt consolidation organizations that negotiate with over 50,000 creditors to help develop a debt consolidation repayment plan or credit card management plan that will fit the client's budget and help them reach goal of becoming DEBT FREE. The website's About Us section lists the following things ORG can do:

- Save you THOUSANDS of dollars in interest expense
- Reduce your repayment period DRAMATICALLY
- Lower your total monthly payment
- Avoid bankruptcy proceedings
- Improve your household's monthly budget
- Preserve your Peace of Mind
- End aggravating creditor calls at home or work
- Enhance your credit history
- Write ONE monthly payment and ALL your creditors are paid

The website also contains a Debt Consolidation & Credit Management Articles and Resources section. This section includes articles such as: "Why We Spend", "How to Conquer the Money Fog", "The Secret to Keeping your Budget on Track ", and "Money saving: Use a Price Book". The articles available are intended to get interested individuals on the right track to living debt free. The rest of the website primarily focuses on questions, case studies, and testimonials related to debt consolidation activities.

The educational material distributed by ORG included: *Making Cents Educational Booklet*, *Your Guide To: Household Budgets, Credit Cards & Electronic Banking* and *Making Cents Financial Literacy Program*. The educational materials are distributed to individuals who attend seminars and are mailed to individuals who contact ORG for information and/or counseling.

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ORG provided a list of all radio appearances and seminars held during the years under examination. Based on the list, the organization had a weekly radio appearance where different topics relating to credit and finances were discussed. The organization also conducted a number of seminars in County and County at different organizations. Most of the seminars were conducted by credit counselor, RA-1. Some of the topics discussed during the workshops included: budget skills, credit card dangers, seniors and Credit Cards, etc. **See Exhibit #3 for complete list of radio appearances and seminars.**

Service Agreements:

On December 30, 20XX, ORG (now ORG) entered into a fulfillment agreement with CO-1, Inc, a for-profit corporation, to provide fulfillment, back-office, and customer relations for its budget plan clients. In the fulfillment agreement, the obligations of CO-1 included:

1. Preparing a proposal to creditors reflecting the budget plan approved by the client;
2. Communicating the proposal to the creditors;
3. Negotiating with the creditors any necessary or appropriate changes in the proposal;
4. Obtaining the client's approval to any changes to the budget plan negotiated with the creditors;
5. Receiving, depositing, and disbursing client budget plan payments;
6. Negotiating with clients any claims from clients for refunds and disbursing funds;
7. Responding promptly to client inquires regarding disbursements and balances.

The terms of the agreement required ORG to maintain and afford CO-1 full access to, one or more accounts for the deposit of budget plan payments from clients, disbursements of refunds, if any, 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 or fair share contributions made through the forgiveness of a portion of the client payments due. CO-1's compensation for services included: a one-time fee of \$ per new budget plan client; a fee of \$ per budget plan client per month for each client for whose account CO-1 received or made a budget plan payment during the course of the month; ORG shall also cover postage, check printing, ORG letterhead and envelopes, along with all methods of receiving and transmitting client payments. Each January 1 all fees payable to CO-1 shall increase by 3%. The term of the agreement was for 5 years and shall automatically be extended for an additional 5 years unless either party has given notice to the other no less than 1 year to the end of the then-current period that the term shall expire at the end of that period. **See Exhibit #4 for complete agreement.**

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ORG also has agreements with other for-profit organizations for referral and lead services. There are no written contracts between ORG and these organizations. During the years under examination, ORG paid the following in fees to aforementioned for-profit organizations.

Per Books – June 30, 20XX	Per Books – June 30, 20XX
Legal fees	Legal Fees
Client fees - CO-1	Client Fees - CO-1
Processing fees - CO-1	Processing Fees - CO-1
RPS service fees - CO-1	RPS Service Fees - CO-1
Referral	Referral
Total	Total

Loans:

In the tax year ended June 30, 20XX, ORG made a series of loans totaling \$ to CO-6, a for-profit corporation ran by directors of ORG, DIR-5 and DIR-6. There were no loan agreements in place. The loan is still outstanding.

In the tax year ended June 30, 20XX, ORG made two loans in the amount of \$ to CO-7, a for-profit ran by DIR-5. There were no loan agreements in place. The loan is still outstanding.

'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.

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)-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

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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 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)(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.

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

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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 93 (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 of 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 fee 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 Counsel Service of Alabama is an umbrella organization made up of numerous credit counseling service agencies. 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. 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 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 payment of the fee would cause 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 organization 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 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

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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 cause 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 than a charitable purpose, the court considered the 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

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recreational component of the tours, but did not 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., 20XX), 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)).

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." 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. Treas. Reg. § 1.501(a)-1(c). The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity" United Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 1999). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

Where an organization provided a source of credit to companies of which a private shareholder was either an employee or an owner, the court found that a portion of the organization's net earnings inured to the benefit of that private shareholder. Easter

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House v. United States, 12 Cl. Ct. 476 (1987). That such loans were made showed that the companies controlled by the private shareholder had a "source of loan credit" in the organization.

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

(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

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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. ORG receives all of its all clients through purchased leads or from their website. The counseling sessions are held to determine if the client has enough disposable income to enter a DMP. ORG does not retain client files or have any further contact with them once their files are transferred to CO-1 for processing.

The material posted on ORG's website is both very general and inspirational, or promotes its debt management plan (DMP). The website contains a few articles relating to debt consolidation and credit management. 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 website does not qualify as public education.

ORG is similar to the organization in *American Institute for Economic Research* that the court concluded had 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 *American Institute for Economic Research*, 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 *Consumer Credit Counseling Service of Alabama, Inc.* The Consumer Credit Counseling Service of Alabama 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;

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- 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 United Way. An incidental amount of their revenue was from service fees.

During the years 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 Organization Act (CROA), 15 U.S.C. section 1679, et.esq. 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 fully providing services. In addition, if ORG were for-profit, federal law would prohibit it from purchasing leads, similar to its agreements with for-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 "CO-4" 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 years, ORG stated that it provided education to the public on the proper use of credit cards and debit cards, in addition too, debt management training programs to the public. What ORG deems to be credit counseling is merely a process to determine if potential clients qualify for a DMP and can afford the monthly payments required of a DMP. All of ORG's income is derived from DMP-related activities.

The facts in ORG's case also show that its activities serve to promote the private business interest of CO-1, rather than 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

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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.

ORG provided a series of loans to CO-6 and CO-7 during the years under examination. The for-profit organizations were run by DIR-6 and DIR-5, directors of ORG. There were no formal written agreements and the loans are still outstanding. These loans constitute inurement in contravention of section 501(c)(3).

Taxpayer's Position

The exempt organization's position has not been determined.

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, ORG was operated for the purpose of serving a private benefit rather than public interests, and a part of the net earnings of ORG inured to the benefit of a private shareholder or individual.

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