



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201226029**
Release Date: 6/29/2012

Date: April 5, 2012

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.03-00; 501.32-00; 501.33-01

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.

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

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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: February 28, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend

A =

B =

C =

D =

Law Firm =

Letter 1 =

Letter 2 =

Letter 3 =

Dear :

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

Facts

You were formed in 2009 by A and B, principals in Law Firm. Law Firm is a private law practice now focusing on estate planning, small business law and formation, elder law/mediation, and the purchase and sale of real estate.

Your Articles of Incorporation were filed on January 13, 2009. Your stated purpose, in part, is "to provide legal services for homeowners at risk, or in the process of, foreclosure, on their real property and other related legal and educational services. All funds shall be devoted to said purposes." Your Articles anticipate that you will be financed through donations and grants.

You stated in your Form 1023 ("application") that you assist an average of 10 at-risk homeowners per month with foreclosure prevention and loss mitigation, housing counseling, reverse mortgage counseling, and homeowner education. You explained in Letter 1 that you provide legal services and "housing/credit counseling" to homeowners at risk of losing their principal residence to foreclosure by facilitating workout programs between the homeowner and his or her lender. You also encourage homeowners to "work with credit card companies on a more manageable payment plan." In Letter 2, you explained that you assist clients in dealing with unsecured creditors by helping them create a stable and realistic budget. You encourage your clients to speak directly with their creditors, but your attorneys are available to help work out an affordable payment or settlement plan. You sometimes negotiate with creditors for more manageable payment plans.

When asked to explain how Law Firm's services differ from services you provide, your response was that you do not charge a fee, unlike Law Firm, which charges standard industry fees for its legal services. Also, your services are provided to homeowners at risk of losing their primary residence in an effort to prevent foreclosure, mitigate losses, and stabilize their financial and legal situation as homeowners. Law Firm did counsel clients on foreclosure prevention in the past, but ceased doing so after A and B established you to provide those services at no charge to homeowners.

You represented that you separate your services and clients from those of Law Firm. People who contact Law Firm for the services you provide, or about any issue which will place them in jeopardy of losing their mortgage, would be referred to you in order to receive these services at no charge. If any of your clients were to inquire about estate planning matters or ask where they or others they know could seek legal services, you may then share information about Law Firm. Although you have offices in the same building, you pointed out that you are in separate suites. You assert that you take great care to protect the distinction between you and Law Firm. However, the message on your voice mail is "Hello, you have reached the law office of Law Firm."

You do not currently provide homeowner education seminars or group financial literacy programs or seminars. Once you receive more funding, you expect to host such seminars. You provided copies of flyers produced by other organizations and institutions showing the seminars that you have attended which were sponsored and hosted by other entities and individuals such as local congressmen and your state attorney general. It is not clear whether you provide these publications to your clients or use them in an independent educational program. You advise and counsel individuals on financial management and the legal ramifications during attorney-client meetings.

The educational programs you plan to host provide very general information focusing on the legal ramifications of homeownership, which include contract and creditor law. Although you stated in your Letter 3 to the Service and in your *Application for Approval as a Housing Counseling Agency* to the Department of Housing and Urban

Development (HUD) (HCA) that you will provide homebuyer education services in order to qualify for and retain HUD certification, you failed to explain the details of any education programs or seminars.

You provided conflicting information as to whether you will charge a fee for your services and whether you only serve a charitable class of individuals. In Letter 1, you stated that you do not provide your services to a particular class of individuals nor do you have an income restriction. In fact, you distinguish yourself from legal service organizations that focus on the poor and the indigent because you offer free legal representation to homeowners in danger of losing their primary residence regardless of income, employment, or other status.

To substantiate your assertion that you do not charge any fees for your service you submitted a business plan stating you do not charge a fee regardless of income, employment or other status, a reference guide for displaced workers produced and compiled by a member of congress that lists you as providing "free counseling", and a copy of your standard retainer agreement which cites there is no fee for your representation. In your HCA Application, you state that your services will be provided "at little or no cost to those clients in most need" of your services, and that you do not anticipate charging a fee for a majority of your housing counseling. However, you will charge for cases requiring extensive time and comprehensive legal work, and you would charge a fixed intake fee of \$125 to cover out of pocket expenses and administrative office support time. You maintained that the "initial screening interview/consultation is at no charge to client."

The business plan you submitted details your operational plans. Your first goal is to obtain federal tax exemption so that you can qualify to be certified by HUD and your state housing development authority to do homeowner counseling and potentially receive funds through various government programs. This will allow you to expand your funding to serve more homeowners in crisis. You have already developed a "benchbook" to systemize the approach an attorney can take to help a client.

You plan to franchise your business model as soon as you prove it viable. You provided an organizational chart showing that each of the individual offices will be staffed by an independent contractor attorney with control remaining in your Board of Directors. Your first independent contractor was B, who is your founding Vice President.

Your application anticipates revenues exceeding three million dollars by your third year of operation. You expect that a significant portion of your funding will come from HUD and other government agencies and through donations. To date, however, you have not received HUD certification or applied for any grants. Your primary support has been from A as an individual and from Law Firm. A and Law Firm also donated in-kind services of office supplies, equipment, and access to professional development training

and seminars. You also received a private gift of \$300, and a contribution from a mortgage financing company of \$10,000. You foresee expenses increasing much more slowly than revenues, to a total of less than \$275,000 in your third year of operations, according to your application.

Your business plan contains other inconsistencies compared to your Form 1023 and HCA Application. For instance, in the former you include a "2009 -2010 Budget" that states your salaries are \$150,000, and that you anticipate serving 75 clients on a monthly basis with expected annual revenue of \$3,002,980. Whereas, in the latter, your salaries are \$200,000 and you expect to serve 10 clients a month and earn annual revenue of \$512,500. It is not clear what time period this budget covers.

You receive referrals for your services from a variety of sources such as your local congressional office, realtors, title companies, and as a result of being a part of the United Way Foreclosure Prevention Task Force. You have stated that you do not receive fees for referrals that you make to other organizations, but you have not said whether you pay fees for any of the referrals that other entities make to you.

At the time of your incorporation, your board was comprised of two directors, both of whom were your initial founders. The President serves as Legal Director and the Associate Legal Director serves as Vice President. Your founding President and founding Vice President, respectively A and B, practiced law together in Law Firm owned by A. Your By-laws permit directors to be employees or independent contractors. D, also a practicing attorney, is now the third director. You have not provided any information to indicate whether he fulfills any role for you other than as a director. During the application period, B left private practice to return to academia. However, you did not provide any proof of her written resignation from the board as required by your Bylaws. Evidently, she was replaced by another practicing attorney, C, who is described as being your only attorney and housing counselor.

You have given conflicting explanation of compensation. Originally you planned to pay salaries to A and B of \$110,000 and \$90,000, respectively. However, you later indicated that A was working Pro Bono and that B receives \$11,250 annually for her work as an attorney, but not for her work as Associate Legal Director. It is unclear whether this compensation was paid for her work as an attorney performed for you or for Law Firm. Still later, you stated that client representation is now provided Pro Bono by both A and C. You do not explain whether you will resume paying compensation to both or either attorney or the amount each were to receive upon receiving approval of your HCA Application.

You have provided resumes for each of your directors. A and C provide private legal services in the following areas: estate planning and administration, probate, guardianships/conservators, Medicaid, elder law. A also practices real property law, foreclosure prevention/loss mitigation, reverse mortgage counseling and small business

law and formation. C has completed an Advanced Foreclosure: Case Study Practicum from Neighborworks, an organization that provides instruction and certification for housing counselors. She is the only person in your organization who has received any certification from them. You said that you do not provide training to any of your attorneys. The resume of D shows that his practice is concentrated in: business organizations, contracts, IT and licensing agreements, franchise agreements, commercial disputes, construction, and real estate development issues. A's Law Firm also purchases and sells real property.

You have also provided inconsistent information as to whether you employ any other personnel to assist you in your operations. Neither in your application to us, nor in any other response to our questions did you indicate that you had any other volunteers or employees. However, your HCA Application stated that you employ the office manager and legal assistant of Law Firm to maintain your client management system. She works less than 35 hours per week for you, and her salary was indicated as being paid by Law Firm, but you stated in the HCA Application that you expected to pay her salary directly within a year.

You commence your services with your clients by meeting with them one-on-one to determine the type of services they seek. The average amount of time that you spend on an initial consultation with a client varies from 30 minutes to 90 minutes depending on a particular client's needs. Those at risk of losing their home complete an intake form, and you then assist with loan modifications and workouts with the lender(s) to help the client mitigate his or her loss, and maintain the mortgage and consequently the home. You also help the client to achieve overall financial health, so that he may maintain stable homeownership. If a client is forced to sell his/her home, you review the entire short sale package the client intends to submit to the bank, and you advise the client on the implications and ramifications of the short sale, including whether or not it is in their best interest. In appropriate situations you will write a support for the short sale to the lender. In situations where a short sale is not beneficial to the client, you may discuss other options, such as a deed in lieu of foreclosure.

When asked whether Law Firm will provide any services when a short sale is the best option for a client, you distinguished the services of Law Firm as involving the "purchase and sales of real property" for clients who want to buy a home and retain legal services for the review of purchase agreements and closing documents.

For your housing counseling services, one of your attorneys begins working with the client on examining his overall budget and deciding what expenses can be curtailed and/or eliminated, and how a housing payment fits into this structure. For some clients with high and/or ballooning interest rates, the counseling sessions look at options and programs available so that the client may qualify for a lower interest rate or stabilize their ARM/balloon payment. For those clients that are in need of more intense modifications, you work with the client and the lender on a modification or workout that

best fits the needs of all involved. If during a counseling session it becomes apparent that the client is in need of other services you help the client obtain information on free local resources or services. You do not require clients who participate in your counseling sessions to engage in ongoing educational programs during the course of your counseling.

You explained that your reverse mortgage counseling is provided to clients who are age 62 and older and faced with the possibility of losing their home because of limited income. You explain to the client the pros and cons of obtaining a reverse mortgage and determine if this option is in his best interest. You stated that you will not offer any certification for the reverse mortgage counseling at this time, but implied that you may provide it upon receiving favorable federal tax exemption. You explained that Law Firm counsels clients who are in stable financial situations for reverse mortgages, in connection with estate planning. You would refer anyone not at risk of losing his home to Law Firm.

When asked to explain your assertion that you do not provide credit repair, debt management plans, debt repayment, debt consolidation, debt negotiation services, or similar types of services, you explained that you do not provide these services in the same manner as a debt management company because you do not make payments on behalf of clients, nor do you collect monthly payments from clients. You provide counseling and walk a homeowner through a budget and discuss options available to them to assist with debt repayment. You also contact and negotiate with both secured and non-secured creditors to resolve the debt through a work out plan, but your clients pay their creditors directly. Your HCA Application included a Housing Counseling Agency Activity Report showing that one of your clients entered a debt management plan.

According to Letter 1, you have helped over 100 homeowners. However, when asked about the results achieved, you failed to provide any substantiation such as copies of agreements between you and mortgage holders, homeowners, banks or mortgage companies, citing that client information is confidential. When asked to apportion revenue and expenses between the operations of each service that you provide, you responded that this was not possible because you could not predict the future needs of homeowners in your state.

Law

Section 501(c)(3) of the Code provides that corporations may be exempted from tax if they are organized and operated exclusively for charitable or educational purposes and no part of their net earnings inures to the benefit of any private shareholder or individual.

Section 501(q) of the Code provides that organizations which provide "credit

counseling services” as a substantial purpose shall not be exempt from taxation under §501(a) unless they are described in §§501(c)(3) or 501(c)(4) and they are organized and operated in accordance with the following requirements: (A) The organization: (i) provides credit counseling services tailored to the specific needs and circumstances of consumers; (ii) makes no loans to debtors (other than loans with no fees or interest) and does not negotiate the making of loans on behalf of debtors; (iii) provides services for the purpose of improving a consumer's credit record, credit history, or credit rating only to the extent that such services are incidental to providing credit counseling services; and (iv) does not charge any separately stated fee for services for the purpose of improving any consumer's credit record, credit history, or credit rating.

Section 501(q)(1)(C) of the code provides that the organization establish and implement a fee policy that is (i) reasonable; (ii) allows for waiver of fees if consumer is unable to pay; and (iii) cannot charge fees based in whole or in part on a percentage of the consumer's debt, the consumer's payments on a debt management plan, or projected/actual savings from enrolling on a debt management plan.

Section 501(q)(1)(D)(i), (ii), and (iii) of the Code provides for a board of directors that (i) represents the broad interests of the public; (ii) not more than 20% of the voting power of which is vested in persons who are employed by the organization or who will benefit financially (other than through the receipt of reasonable director's fees or the repayment of consumer debt to creditors other than the credit counseling organization); and (iii) not more than 49% of the voting power of which is vested in persons who are employed by the organization or who will benefit financially (other than through the receipt of reasonable director's fees).

Section 501(q)(1)(F) The organization receives no amount for providing referrals to others for debt management plan services, and pays no amount to others for obtaining referrals of consumers.

Section 501(q)(2)(A)(i) of the Code provides that if an organization is described in §501(c)(3) and is providing credit counseling services as a substantial purpose, it may be exempted from tax only if it does not solicit contributions from consumers during the initial counseling process or while the consumer is receiving services from the organization.

Section 501(q)(2)(A)(ii) of the Code provides that if an organization is described in §501(c)(3) and is providing credit counseling services as a substantial purpose, it may be exempted from tax only if its aggregate revenues from payments by creditors of consumers of the organization attributable to debt management plan services do not exceed a specified percentage of total revenues.

Section 501(q)(4)(A) of the Code defines, for purposes of §501(q), the term “credit counseling services” to mean (i) the providing of educational information to the general

public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of consumer credit; (ii) the assisting of individuals and families with financial problems by providing them with counseling; or (iii) a combination of the activities described above.

Section 501(q)(4)(B) of the Code defines, for purposes of §501(q), the term “debt management plan services” to mean services related to the repayment, consolidation, or restructuring of a consumer’s debt, and to include the negotiation with creditors of lower interest rates, the waiver or reduction of fees, and the marketing or processing of debt management plans.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (“regulations”) provides that, in order to be exempt as an organization described in §501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(a)(2) of the regulations provides that the term “exempt purpose or purposes” as it is used in §1.501(c)(3)-1 of the regulations means any purpose or purposes specified in §501(c)(3) of the Code.

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 §501(c)(3) of the Code. 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) of the regulations defines the words “private shareholder or individual” in §501 of the Code 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 assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and, specifically, 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 §501(c)(3) in its generally accepted legal sense and includes the relief of the poor and distressed or of the underprivileged.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations provides that the term "educational," as used in §501(c)(3) of the Code, relates 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. 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under §501(c)(3).

In Rev. Rul. 69-161, 1969-1 C.B. 149, the classic legal aid society is described and as held an organization that provides "for legal services to indigent persons otherwise financially incapable of obtaining such services" is exempt under IRC §501(c)(3). By providing essential legal services to the indigent, the organization relieves the poor and distressed; therefore, the activity is charitable.

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 §501(c)(3) of the Code because it relieved the poor and distressed and educated the public. 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. The organization did not charge fees for counseling services or proration

services. The organization did not make loans to debtors or negotiate loans on their behalf

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (individual and group counseling of widows, where fees charged for services were based on ability of the widow to pay); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 178 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (personal marriage counseling and public seminars supported by area churches, clients' fees, and contributions); Rev. Rul. 68-71, 1968-1 C.B. 249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free or below-cost, and the organizations were supported by contributions from the public.

Rev. Proc. 2012-9, 2012-2 I.R.B. 258, provides that exempt status may be granted in advance of the organization's operations if the proposed activities are described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption pursuant to the section of the Code under which exemption is claimed. All activities for which the organization expects to engage must fully be described including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of the contemplated expenditures. A mere restatement of exempt purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy the requirement.

In Scripture Press Foundation v. The United States, 285 F.2d 800 (1961), cert. denied, 363 U.S. 985 (1962), a separately organized publishing corporation, not connected with any particular religious denomination or church, sold a large volume of religious literature, periodicals, and Sunday school supplies at a substantial profit. The court found that operating profits and accumulated earnings were disproportionately large and there was no clear purpose to further any particular religious beliefs. The general charter of the operation was that of a commercial publishing house catering to religious customers. Thus the Court concluded that the organization was primarily engaged in trade or business and not exempt under section 501(c)(3) of the Code. The existence of a modest program of expenditures for religious and educational purposes unconnected with the publishing did not have a decisive effect. See also Christian Manner International v. Commissioner, 71 T.C. 661 (1979).

In Founding Church of Scientology v. United States, 412 F.2d 1197, 188 Ct. Cl. 490 (Ct. Cl. 1969), cert. den., 397 U.S. 1009, 90 S. Ct. 1237, 25 L. Ed. 2d 422 (1970), the court, without considering the organizations beliefs, held that it did not qualify for exemption under IRC §501(c)(3) because its net earnings inured to the organization's

founder and members of his family. The organization argued that it had paid its founder for expenses incurred in connection with his services, made reimbursements to him for expenditures on its behalf, and made some payments to him as repayments on a loan. The organization could produce no evidence of contractual agreements for services, documents evidencing indebtedness, or any explanation regarding the purposes for which expenses had been incurred.

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), provides that an organization seeking a determination letter or ruling as to the recognition of its tax-exempt status has the burden of proving that it satisfies all of the requirements of the particular tax-exemption category.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services did not satisfy the operational test under §501(c)(3) of the Code 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, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of typical §501(c)(3) organizations. 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, while to some extent the fees charged reflected ability to pay, it did not appear that the corporation ever planned to charge a fee less than "cost."

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

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

The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. As such, the community and education counseling assistance programs were the agencies' primary activities. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way. An incidental amount of their revenue was from service fees. Thus, the court concluded that "each of the plaintiff consumer credit counseling agencies was an organization described in §501(c)(3) as a charitable and educational organization."

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 when reasoning that:

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 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, 12 Cl. Ct. 476 (1987), *aff'd*, 846 F. 2d 78 (Fed. Cir. 1988) cert. denied, 488 U.S. 907, 109 S. Ct. 257, 102 L. Ed. 2d 246 (1988), the court found an organization that operated an adoption agency was not exempt under §501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt

commercial purpose. The court concluded that its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court found that the health-related services were merely incidental to the organization's operation of an adoption service. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits.

American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), concerned a school that trained individuals for careers as political campaign professionals. The court held that the organization did not exclusively serve purposes described in §501(c)(3) of the Code because it operated on a partisan basis, thereby serving private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with a particular political party and that most of the organization's graduates worked in campaigns for that party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferring of benefits on disinterested persons who are not members of a charitable class may serve a private interest within the meaning of §1.501(c)(3)-1(d)(1)(ii) of the regulations.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the U.S. Court of Appeals for the Seventh Circuit upheld a Tax Court decision that an organization operating restaurants and health food stores in a manner consistent with the doctrines of the Seventh Day Adventist Church did not qualify for exemption under §501(c)(3) of the Code because the organization was operated for a substantial nonexempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in competition with other restaurants, engaged in marketing, and generally operated in a manner similar to commercial businesses.

The court in Redlands Surgical Services v. Commissioner, 113 T.C. 47 (1999) stated that merely entering a partnership with private parties in which they receive a return on a capital investment does not impermissibly confer private benefit. However, a detailed examination of the Redlands surgery center venture convinced the court that the petitioner had ceded control to private parties having an independent economic interest in the activity and no obligation to promote charitable purposes ahead of profit making. Therefore, the applicant was not operated exclusively for exempt purposes. The Court pointed to the long-term management contract with a party related to the for-profit, with broad discretion, and a fee based upon gross revenue. Furthermore, the record did not show that the nonprofit had any role in negotiating the contract, and that it was executed for both parties by the same individual, indicating self-dealing. Nor did the record show that the petitioner had any informal control as it did not have the resources or the ability to oversee the operations.

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 nonexempt commercial purpose, rather than for an exempt purpose. As the court stated:

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.

In Solution Plus, Inc. v. Commissioner, T.C. Memo. 2008-21, the Tax Court held that a credit counseling organization was not exempt under §501(c)(3) because it was not organized and operated exclusively for educational or charitable purposes and impermissibly served private interests. The organization was formed by an individual with experience selling debt management plans ("DMPs"). The founder and his spouse were the only members of the organization's board of directors. The organization did not have any meaningful educational program or materials to provide to people who contacted the organization, and its financial education seminars for students constituted an insignificant part of the organization's overall activities.

The Court held that the organization's purposes were not educational because its "activities are primarily structured to market, determine eligibility for, and enroll individuals in DMPs." Its purposes are not to inform consumers "about understanding the cause of, and devising personal solutions to, consumers' financial problems," or "to consider the particular knowledge of individual callers about managing their personal finances." The Tax Court also held that the organization's purposes were not charitable because "[its] potential customers are not members of a [charitable] class that are benefited in a 'non-select manner' * * * because they will be turned away unless they meet the criteria of the participating creditors."

Finally, the Tax Court held that the facts in Credit Counseling Services of Alabama v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978) "stand in stark contrast" because "the sale of DMPs is the primary reason for [Solution Plus's] existence, and its charitable and educational purposes are, at best, minimal."

Analysis

We must examine and consider all the facts and circumstances when determining whether you are organized and operated exclusively for charitable, educational, or other

exempt purposes. An organization seeking exemption must establish that it operates as a §501(c)(3) organization. This requires satisfying the requirements of two main tests before an organization can be recognized as exempt. An organization has the burden of showing that it is both organized and operated exclusively for purposes described in §501(c)(3). Section 1.501(c)(3)-1(a)(1) of the regulations. You fail both tests.

Organizational Test

To demonstrate that it is organized exclusively for exempt purposes, and thus satisfies the organizational test, an organization must have a valid purpose clause in its governing document. Section 1.501(c)(3)-1(b)(1)(i) of the regulations. A valid purpose clause limits the organization's purposes to one or more exempt purposes and does 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(b)(1)(i) of the regulations.

Your Articles do not express an exempt purpose and do not limit your activities to those that further one or more exempt purposes, such as relieving the distress of the poor or underprivileged. Your declared purpose of providing legal services to the general public is not an exempt purpose. Unlike the organization in Rev. Rul. 69-161, which provided essential legal services to the indigent, you provide services to homeowners in danger of losing their primary residence regardless of income, employment, or other status. Because your purpose is not limited to one of those recognized by statute as exempt you are not organized for exempt purposes.

Operational Test

An organization must also establish that it is operated exclusively for one or more exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations. 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 § 501(c)(3) of the Code. Section 1.501(c)(3)-1(c)(1) of the regulations. The purpose towards which an organization's activities are directed, and not the nature of the activities themselves, ultimately indicates whether an organization may be classified as a §501(c)(3) organization. B.S.W. Group, 70 T.C. 352, 356-57 (1978).

Your articles do not contain a valid exempt purpose, thus your activities cannot promote one. In addition, as the following analysis of your activities explains, your activities do not themselves indicate or achieve an exempt purpose. While some of your activities may further incidental educational and charitable purposes, your activities primarily further the substantial nonexempt purposes of operating in the same commercial manner as similar for-profit law firms and benefiting your founder and her private interests.

You Are Not Operated Exclusively for Educational Purposes

Your activities demonstrate that you do not operate exclusively for educational purposes within the meaning of §501(c)(3) of the Code. Your foreclosure and loss mitigation services, housing counseling services, reverse mortgage counseling services, and budgeting services may offer some useful information to your clients. However, offering some useful information in the course of providing financial and legal services does not meet the regulatory definition of educational, and is not your primary purpose. The regulations define the term educational as instructing or training an individual to improve or develop his capabilities or instructing the public on subjects useful to the individual and beneficial to the community. Section 1.501(c)(3)-1(d)(3)(i).

You currently do not provide your clients with any educational services prior to or throughout the entire budgeting development process, modification or workout plan process other than referring them to outside counseling services. Neither did you describe or submit the training or information you do or plan to provide at public forums, nor did you describe or submit any information as to the homebuyer education services that you plan to provide in order to qualify for and retain HUD certification. A mere statement of your intentions is not enough to qualify them as educational activities. See Rev. Proc.2012-9, *supra*. Furthermore, although you provided copies of flyers produced by other institutions and organizations that list the various topics that will be discussed and services to be provided, it is clear that your role will be an insignificant part of your overall activities.

You failed to state the percentage of your time that you devote to providing one-on-one counseling. You also did not provide any information showing whether you follow-up with your clients and neither did you explain the point at which your relationship with the client ceases. Like the organization in Solution Plus, you have failed to demonstrate that you offer any meaningful educational materials for people who inquire or seek your services.

Financial counseling organizations that have been held exempt in the past primarily informed the public on budgeting, buying practices, and the sound use of consumer credit. Consumer Credit Counseling Service of Alabama, 78-2 U.S.T.C. 9660 and Rev. Rul. 69-441, *supra*. Any financial services such as debt management programs were incidental to these primary educational activities. The goal of your counseling sessions for each of the type of services you provide is to achieve the best option available to the client. Unlike financial counseling that has been recognized as exempt, your counseling are not structured primarily to improve your clients' understanding of their financial problems or their skills in solving them. Rather, they are mainly structured so that you serve as an intermediary between your clients and their

creditors or mortgage lenders to create a mutually agreed upon payment or workout plan. These activities, then, are not primarily offered to provide instruction or training "useful to the individual and beneficial to the community" within the meaning of §1.501(c)(3)-1(d)(3)(i) of the regulations.

Thus, you have not demonstrated that you are operated exclusively for educational purposes within the meaning of §501(c)(3).

You Are Not Operated Exclusively for Charitable Purposes

Providing services that relieve the distress of the poor, a recognized charitable class, furthers a charitable purpose. Section 1.501(c)(3)-1(d)(2). Counseling poor people about economics and personal finance can achieve an exempt purpose. See Rev. Rul. 69-441, supra. However, you do not restrict any of your services to the poor or those recognized by the law as "distressed." Your services are available to persons of any income, employment or financial status who are either worried about paying their mortgage or who are in jeopardy of losing their home. The fact that persons whose incomes exceed their area median income (AMI) may utilize your services means that those persons whose incomes are well below AMI will be competing for your services.

You Have a Substantial Nonexempt Purpose

An organization does not qualify for exemption if more than an insubstantial part of its activities furthers a non-exempt purpose. Section 1.501(c)(3)-1(c)(1). A nonexempt purpose may be evidenced by activities that are conducted in a commercial manner or for a commercial purpose. In discerning whether an organization has a substantial nonexempt commercial purpose, courts focus on a number of factors related to the nature of the activities and how an organization conducts its business, including pricing policies, funding sources, build up of capital assets, and the organization's competitiveness with and similarity to other commercial ventures. See *e.g.*, B.S.W. Group, 70 T.C. 352; Easter House, 12 Cl. Ct. 476; Airlie Foundation, 283 F. Supp. 2d 58; Living Faith, 950 F.2d 365.

Providing legal and financial services to the general public is normally a commercial purpose. In fact, your founder used to provide the same services through Law Firm. Conduct of a commercial trade or business does not preclude exempt status, but the commercial activity must promote an exempt purpose. Living Faith, Scripture Press. As discussed above, you do not have an exempt purpose.

The way that you conduct your activities provides further evidence that you do not have an exempt purpose. You have not added the significant educational activities for individuals and the general public that were the basis for exempt status of other financial counseling organizations as discussed above. You do not limit your services to a charitable class. You are controlled by persons with personal and financial

interests in your activities. You make and accept referrals from for profit entities. You plan to franchise your business, and to earn a significant excess of revenue over expenses. Your operations are indistinguishable from other for-profit law firms that practice in the same specialty areas except for your expectation of revenue from government agencies and charitable foundations.

You have not demonstrated whether your services are offered below cost. You have provided us with information showing the compensation paid by other legal service organizations to their attorneys. However, you have not given us any information showing what the costs of each of your services were when conducted by Law Firm. Additionally, your pricing policies have been inconsistent. On several occasions you maintained that you do not charge a fee for any of your services, however you state within your HCA Application that you would charge a fixed administrative fee of \$125 for cases requiring extensive time and comprehensive legal work.

Your financial structure provides additional evidence of your commercial purpose. Your business plan is based on receiving substantial grants and contributions. Within three years of incorporation, you expected to have revenues of three million dollars. However, to date you have not received any government grants and there is no evidence that you have received contributions or gifts from disinterested members of the public. See B.S.W. Group, 70 T.C. 352 (citing lack of contributions and sole support from fees as factors disfavoring exemptions). Rather, you have submitted information showing that you received a contribution of office supplies and furniture worth \$10,000 from a mortgage financing company that you have not shown to be a detached and disinterested generosity from a contributor and in-kind and financial support from Law Firm. Your financial data included expenses of less than \$275,000 for the year in which you anticipated revenue of three million dollars. A significant and unexplained excess of revenue over expenses is another characteristic of commercial purpose. Scripture Press.

Inurement

An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in any part to the benefit of private shareholders or individuals. Section 501(c)(3) of the Code; Section 1.501(c)(3)-1(c)(2) of the regulations.

Assuming you had a legitimate exempt purpose, you would still be required to show that none of your net earnings inure to the benefit of private individuals. See §1.501(c)(3)-1(c)(2) of the regulations. A minimal amount of inurement is fatal to exemption. An important factor in deciding whether an organization operates for the benefit of private interests is how an organization is controlled. See P.L.L. Scholarship v. Commissioner. Through Law Firm, A, C, and D each has a consanguineous business relationship with you. Furthermore, A appointed all of your board members. Unlike the organization in Rev. Rul. 69-441, your directors are not selected from the

broad community. They all have a personal financial interest in your activities, and are considered private individuals within the meaning of §1.501(a)-1(c) of the regulations. When private individuals or for-profit entities, such as A and Law Firm, have either formal or effective control of a non-profit organization, it raises questions concerning whether the organization furthers the profit seeking motivations of those private individuals or entities. See Rev. Rul. 67-5 and Redlands, *supra*.

Net earnings may inure to A and other board members as a result of you sharing your assets or other resources with Law Firm. As discussed above, your application contains inconsistencies as to how much rent you actually pay. In your business plan you state that your monthly rent is \$250, but in your HCA Application it is listed as a \$1000. You did not provide a copy of the lease agreement for Law Firm, so it is unclear exactly what it covers, when it expires or whether Law Firm will begin to utilize your office space. Your voice mail's outgoing message announces "Hello you have reached the law office of ..." and the name Law Firm is stated. Your by-laws permit your directors to be paid as employees or independent contractors. Three of your current employees are also employees of Law Firm. Law Firm currently pays the salary of your part-time office manager, but it is unclear whether that person will continue to manage the Law Firm after you begin paying her salary.

Your earnings may inure to A directly and indirectly through Law Firm, and may also inure to your other attorney board members. You expect substantial revenue and excess of revenue over expenses, but you have not established any procedural or structural safeguards to prevent diversion of your assets. You have failed to show that your operations will not benefit A or any of the for-profit companies owned by her. Therefore, we cannot find that your assets will not inure to the benefit of related parties.

Private Benefit

An organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. See section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

Private interests include designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly by them. Section 1.501(a)-1(d)(1)(ii). Private individuals may receive incidental benefits that are a necessary concomitant to achieving an exempt purpose. See American Campaign Academy v. Commissioner. Even if we agreed that you have an exempt purpose, you have not demonstrated that benefits to your creator and the private firm that she owns are incidental to it.

Your operations substantially benefit A, Law Firm, and C and D in many ways: client referrals, employment, training, and networking opportunities. You were created to generate a new source of revenue for work previously performed by Law Firm's

employees. You refer clients to Law Firm and promote its services. Law Firm refers clients who cannot pay fees to you, allowing it to benefit from the ability to indirectly assist potential clients. You provide, or will provide, salaries to employees of Law Firm, relieving it of the obligation of full compensation. Your proposed activities dovetail with those of Law Firm. This integration with for-profit entities is similar to relationships between exempt organizations and related for-profits in est of Hawaii, and Church by Mail. Those courts found that the exempt organizations were operated to provide substantial private benefit to the commercial entities and therefore were not entitled to exempt status.

Furthermore, you are controlled by directors who are all licensed attorneys, without public participation of any kind. You intend to franchise your operation for the benefit of other independent attorneys. An exempt organization certainly may compensate its employees. But when the employees control the organization and have separate financial interests, as in your case, it suggests that the organization is operated for private rather than public benefit. as in Rev. Rul. 71-170. Thus, the private interests of these individuals benefit by more than an insubstantial amount.

You assert that you have taken steps to avoid private benefit by explaining the distinction between the services you offer and those offered by Law Firm when a client comes into your office seeking services provided by the latter and *visa versa*. However, this does not eliminate the benefit of the referrals to Law Firm, and actually serves to promote Law Firm. To substantiate that your office facilities are separate you provided photographs of your office space and signage. However, your space is adjacent to Law Firm, you share the same phone line, as well as three employees, suggesting that the separation is incomplete.

Thus, your operations may substantially benefit all of your attorney board members and Law Firm. All are in a position to gain financially from your activities unlike the organization in Rev. Rul. 69-441, whose board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions. As reasoned by the Tax Court, in Solutions Plus, T.C. Memo 2008-21, an organization is operated for private rather than public benefit when its directors, like yours, personally gained from the organization's activities.

Section 501(q) of the Code

An organization that provides educational information on financial topics or financial counseling to homeowners who are at risk of foreclosure is providing "credit counseling services" within the meaning of § 501(q)(4)(A) of the Code. An organization that engages in such activities as a substantial purpose must, in addition to complying with the requirements of §501(c)(3), comply with the provisions of §501(q). You do not meet the requirements of §501(c)(3), but even if you did, you would not meet the requirements of §501(q) which is also necessary for exempt status.

An exempt credit counseling organization must establish and implement a fee policy which requires that any fees charged to a consumer for services are reasonable and allows for the waiver of fees if the consumer is unable to pay. Section 501(q)(1)(C). Although you represent that you will generally not charge fees, you have said that you will charge fees in some cases and you failed to establish that you have a fee policy.

Credit counseling organizations must be governed by a board controlled by persons representing the broad interests of the public rather than by persons who benefit from the organization's activities. Section 501(q)(1)(D) of the Code. All of the voting power of your board is vested in persons who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees) through referrals from the organization and compensation. Accordingly, you do not have a board that is controlled by persons who represent the broad interests of the public as required by §501(q)(1)(D)(i). You also fail to meet the requirements of §§501(q)(1)(D)(ii) and (iii), which generally specify the percent of voting power that is allowed to be vested in financially interested persons.

Credit counseling organizations are not allowed to receive payments for providing referrals to others for services related to the repayment, consolidation, or restructuring of a consumer's debt, which includes the negotiation with creditors of lower interest rates or the waiver or reduction of fees. Sections 501(q)(1)(F) and 501(q)(4)(B) of the Code. Although you have indicated that you do not receive a referral fee from Law Firm or from any other organization or institution to which you refer clients, you have not said whether you pay anyone who refers clients to you. Therefore, you do not satisfy the requirement that you receive no amount for providing referrals to others for debt management plan services.

Therefore, assuming you were to have otherwise met the requirements of §501(c)(3) of the Code, your failure to satisfy the requirements of §501(q) would prevent you from being exempt from taxation under §501(a).

Conclusion

Based on the facts and information provided, you are not organized or operated exclusively for exempt purposes as required by §§1.501(c)(3)-1(b)(1)(i), 1.501(c)(3)-1(a)(1), and 1.501(c)(3)-1(c)(1) of the regulations. You are organized and operated for a substantial nonexempt purpose which is inconsistent with the requirements of §1.501(c)(3)-1(c)(1) of the regulations. Any public purposes for which you may operate are only incidental to your primary nonexempt purpose. You have not demonstrated that you do not allow your net earnings to inure to private individuals as required by §1.501(c)(3)-1(c)(2) of the regulations. You do not serve a public rather than a private interest as required by §1.501(c)(3)-1(d)(1)(ii) of the regulations. Therefore, you are not described in §501(c)(3) of the Code. In addition, you do not meet the requirements of

§501(q).

Accordingly, you do not qualify for exemption as an organization described in §501(c)(3) of the Code and you must file federal income tax returns. Contributions to you are not deductible under §170.

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.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

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 §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