



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TEGE EO Examinations Mail Stop 4920 DAL
1100 Commerce St.
Dallas, Texas 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: 200846023

Release Date: 11/14/08

Date: August 5, 2008

UIL: 501.03-01

LEGEND

ORG = Organization name XX = Date Address = address

ORG
ADDRESS

Taxpayer Identification Number:
Person to Contact:
Employee Identification Number:
Employee Telephone Number:

LAST DATE FOR FILING A PLEADING
WITH THE TAX COURT, THE CLAIMS
COURT, OR THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF COLUMBIA: 11/3/20XX

CERTIFIED MAIL

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated August 7, 19XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

You are not operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). You are not and have not been engaged primarily in activities which accomplish one or more exempt purposes. You are not a charitable organization within the meaning of Treasury Regulation § 1.501(c)(3)-1(d); rather, your activities further a substantial nonexempt commercial purpose and serve private, rather than public interests.

Contributions to your organization are no longer deductible under IRC §170 after December 31, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

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

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

You also 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 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

See the enclosed Notice 1546, Taxpayer Advocate Service – Your Voice at the IRS, for Taxpayer Advocate telephone numbers and addresses.

We will notify the appropriate State Officials of this action, as required by Code section 6104(c). You should contact your State officials if you have any questions about how this final 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,

Doug Shulman
Commissioner
By

Vicki L. Hansen,
Acting, Director EO Examinations

Enclosures:

Publication 892
Notice 1546
Notice 437

LEGEND

ORG = Organization name XX = Date Website = website Agreement = agreement
Service = service Author - author EMP-1 = 1st employee XYZ = State
BM-1, BM-2, BM-3, BM-4, BM-5, BM-6, BM-7 = 1st, 2nd, 3rd, 4th, 5th, 6th & 7th BOARD MEMBERS
CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7, CO-8, CO-9, CO-10, CO-11, CO-12, CO-13 & CO-14 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, 9th, 10th, 11th, 12th, 13th & 14th COMPANIES
TABLE = TABLE

ISSUE:

Whether ORG is operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3).

Whether ORG had the substantial nonexempt purpose of providing debt management program services to the general public.

Whether ORG was operated for the purpose of serving private rather than public interests?

FACTS:

Background

ORG (ORG) was incorporated on June 2, 19XX as a Domestic Non-profit Corporation in the State of XYZ, located in City. ORG's stated purpose was "*exclusively for charitable and educational purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt under the section 501(c)(3) of the Internal Revenue Code or corresponding section of any future federal tax code.*" The Articles of Incorporation also stated ORG's purpose was to:

"enable the general public to avoid bankruptcy and bad debt write-offs and to repay all outstanding debts, including collections, judgments, and liens. This shall be accomplished by counseling clients, establishing a budget with them and developing a repayment schedule which fits their budget and also satisfies their creditors. The client's funds will be disbursed on a regularly scheduled basis until all creditors are paid in full. Education will be provided to the client's so they can avoid the same pitfalls in the future. This will be done through personal counseling, classes and seminars. We will also provide books, brochures, and audio and video tapes as necessary."

On August 7, 19XX, the Internal Revenue Service (IRS) issued Letter 1045 stating ORG was exempt from federal income tax as an organization described under section 501(c)(3) of the Internal Revenue Code (IRC or "the Code"). ORG also received an advanced ruling that it was publicly supported within the meaning of IRC sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code. On April 21, 20XX, the IRS issued Letter 1050 reaffirming exempt status under IRC section 501(c)(3) with a definitive ruling that ORG was a publicly supported organization described under IRC 509(a)(1) and 170(b)(1)(A)(vi).

On January 24, 20XX, the IRS notified ORG of a pending examination of its books and records to be conducted beginning February 13, 20XX. Specifically, Form 990 for the tax year ended December 31, 20XX was selected for examination. The examination has not been expanded.

Only the P.O. Box mailing address is prominently displayed and made available to the public. There was no record of in-person counseling sessions with clients. Face-to-face sessions were not advertised. ORG did not disclose its physical street address to the public. ORG leases space in an industrial business park. There

was no free educational material in the lobby. Hours of operation were not posted on the doors. ORG had no library, archive or educational center freely available to the public. ORG's website and correspondence did not disclose its physical location.

Based on return information, the books and records were in the care of BM-1. BM-1 was the Executive Director and CEO of ORG, and is the son of BM-2 and BM-3. BM-2 created ORG and furnished all of ORG's initial capital. However, the application for exemption and the subsequent foundation follow-up information on Form 8734 did not list BM-2 as a substantial contributor or a disqualified person with respect to ORG. While BM-1 was officially CEO of the organization, BM-2 and the BM Family have always exercised substantial influence and control over the company.

Board members outside the BM Family had no authority to veto or override votes of the family. They were not provided written instructions, agreements, guidance, duties and responsibilities in connection with their fiduciary duties as board members. Non-family board members were never advised in writing of the extent of their authority and their right to review books and records. Some non-family board members' decisions were primarily based on their trust of BM-2. Non-family board members were added primarily to satisfy requirements of bankruptcy laws and creditors. For example, on 7/6/20XX, ORG decided to add one new board member in response to the enactment of new bankruptcy laws.

The list of directors of the organization, as compiled from the Forms 990 for the years ended December 31, 20XX through December 31, 20XX, and from the Articles of Incorporation is shown on **Exhibit A**.

Minutes

Four board meetings were held in 20XX. Attachments to the minutes that were mentioned in the minutes were not available to examiners, such as budgets. Education was not mentioned in the minutes until after the IRS examination began, and lack of documentation of public education was never questioned by the non-family board members.

ORG's bylaws indicated that "*Regular monthly meetings should be held the last week of every month, unless otherwise designated by the Board of Directors and stated in the notice of the meeting...*" ORG's Board meetings were actually held on the following dates between 20XX and 20XX:

- 1/10/20XX All board members in attendance are family members
- 6/15/20XX All board members in attendance are family members
- 8/16/20XX Four out of five board members in attendance are family members
- 5/6/20XX The majority in attendance are family members. Two new non-family board members added (BM-4 and BM-5), resulting in a 50-50 split of the board.
- 9/16/20XX The majority in attendance are family members
- 12/9/20XX The majority in attendance are family members.
- 3/15/20XX All board members in attendance are family members
- 7/6/20XX The majority in attendance are family members. One new non-family board member added (BM-6), resulting in a 50-50 split in attendance, and an overall majority of non-family on the board of directors.
- 8/19/20XX The majority in attendance are non-family members (4 each). The three family members in attendance abstained from this vote regarding the purchase of servers from CO-1.

Statistics important to the board were labeled "Updates." Below are the only statistics identified by IRS examiners as being presented to the board as of December 9, 20XX.

- Total Active Clients
- Total Active Consumer Debt \$
- Total Client Monthly Disbursements \$
- Average Collected Fair share and "Donations" 11.8%

Projections were made in terms of client enrollment and collected fair-share and "donations."

Related Organizations

The chart on **Exhibit A** indicates the related businesses, the overall organizational structure, and the composition of owners.

CO-2/CO-1. BM-2 formed CO-2¹ as a dialing service and telemarketer for business clients. BM-2 was CO-2's defacto owner since he also owned CO-3, CO-2's only general partner. CO-2 changed its name to CO-1 in June 20XX.

ORG contracted with CO-2 to perform dialing services, making cold calls on its behalf and to serve as a pilot customer in order to launch the telemarketing business for the BM Family in the event of ORG's demise resulting from a decline in fair share. Solicitation calls were automatically generated by special computer servers located offsite and owned by CO-2. ORG purchased the phone lists. The dialing servers randomly called numbers in five states where the solicitations were legal. In 20XX and 20XX, CO-2 made 11,832,945 and 6,298,630 calls respectively on behalf of ORG. The high call volume was expected to result in a number of inquiries. CO-2 operated out of ORG's corporate offices and shared one technical employee with ORG. Below are transcripts of CO-2's telephone solicitations on behalf of ORG:

"Did you know there are secrets to getting out of credit card debt; paying less money and getting out quicker than your creditors want you to, and that the creditors fund programs to make this possible? Hi, I'm EMP with ORG, a nonprofit organization funded by donations. Call now for this free information at. That's; or visit our website:

"Your credit card payments are about to DOUBLE! Some of the major credit card companies have announced they are doubling your minimum monthly payments, with the rest soon to follow. If you're one of the millions who are barely able to pay your minimums now, this could become a real problem. Hi, my name is EMP and I am with ORG. We are an accredited nonprofit organization. Call us TODAY to find out what program and free educational material is available to help you prepare for this major change. Call. That's; or visit

Regarding ORG's sources for clients, ORG's application for exemption stated, "Most of our clients are referred to us from the area churches that see us as a ministry to help others. The local CO-4 bases have been sending us people and the CO-5 also..."

The telemarketing contract was referred to as the Agreement; however, ORG referred to this service as "Service" on Form 990. For the tax years ending December 31, 20XX and 20XX, ORG paid CO-2 \$ and \$

¹ CO-2 is short for

respectively for this service. When asked why ORG should pay CO-2/CO-1 over \$ when internal staff could do the same thing for a much lower price,² ORG could not respond. There were no bids on the acquisition of a comparable telemarketing *service* from third parties. ORG has stated to IRS examiners that television and radio ads would have been too expensive and such ads don't target specific markets.

As a result of the new laws in 20XX relating to the do-not-call registry enforced by the Federal Trade Commission, CO-2 could no longer operate feasibly and needed to dispose of its assets, including the dialing servers. The contract with CO-1 ended on 8/1/20XX. ORG purchased the dialer servers from CO-1 for its own marketing and advertising activities. ORG solicited two more bids prior to the purchase. All bids were as follows:

CO-6	\$ (New servers to be acquired, installed and serviced)
CO-7	\$ (New servers to be acquired, installed and serviced)
CO-1	\$ (Servers are already in place, installed, and operational)

As of the year ended 12/31/20XX, CO-2's fund balance reflected a deficit of \$((\$). In the decision to acquire the dialing servers, BM-2, BM-7, and BM-1 abstained from the vote, and four non-family board members voted and approved the purchase of the equipment from CO-1, on 8/19/20XX for \$.³ As of the end of 20XX, the net book value of CO-1's fixed depreciable assets was \$. Total assets on CO-2's books at that time was \$. ORG paid CO-1 \$ more than the gross book value of CO-2's assets (\$ - \$), and \$ more than the net book value (the approximate adjusted basis) for the assets (\$ - \$). The acquired property was not appraised by a certified independent appraiser.

In 20XX, all family members (except for EMP) owned a limited partnership interest in CO-2/CO-1 such that over half of ORG's board in 20XX had a partnership interest in CO-2. However, CO-2 was not disclosed on Part VI, Line 80 of the 20XX Form 990.

CO-8. BM-2 started CO-8, which was a Subchapter S corporation performing a marketing and consulting service for ORG and other businesses for the years 20XX and ending on 9/30/20XX. The purpose for its formation was to explore business opportunities for the family in the event something happened to ORG as creditors began cutting fair share in early 20XX. CO-8 paid BM-2 a salary in 20XX and 20XX for providing ORG with "consulting" services. "Consulting" included the marketing and advertising function. This was the only time ORG did not pay a salary to BM-2. When the contract with ORG terminated in 20XX, BM-2 was again placed on ORG's payroll.

CO-9 (CO-9) CO-9 was formed to develop the remittance and computer programs utilized by ORG. CO-9 also operated out of the offices of ORG. It was owned by members of the BM Family (limited partnership interests) and (general partner). was owned by BM-2. Though CO-9 filed Form 1065 and flow-through income was reported on individual Forms 1040, never filed returns on Form 1120. Although over half of ORG's board members were partners in CO-9. CO-9 was not listed on Part VI, Line 80 of the 20XX Form 990. Part III of Schedule A of Form 990 disclosed that ORG did not furnish facilities or lease property with disqualified persons or their related companies.

² Conference dated 3/7/20XX. The question was asked of BM-1.

³ August 19, 20XX minutes.

Flow of Exempt Organization's Funds during Normal Operations ORG funds were used to pay fees for consultants, telemarketing and advertising, which was labeled as "Service" on Form 990. These funds ultimately flowed to the family.

1. In 20XX, ORG paid CO-2/CO-1 \$ and reported it as payment of consultant fees for "Service". \$ amounts to 43% of ORG's total expenses, and does not include salaries, wages, and benefits.
2. CO-2/CO-1 reported sales of \$ and paid \$ in telephone expenses and \$ in "professional fees." The "professional fees" were paid to CO-8.
3. CO-2/CO-1 reported ordinary income of \$ for the tax year ending 12/31/20XX.
4. CO-8 reported \$ in gross sales. CO-8 paid BM-2 \$ in compensation and reported ordinary income of \$. Ordinary income was distributed to the family and reported on Forms K-1.

ORG's application for exemption further stated in response to IRS inquiries on Letter 1312 that "*None of the Board members or trustees has any business or consults with any organizations that could benefit from these activities.*"

Employees, Family Compensation

During the year under examination, ORG had nine to ten employees: three phone operators called "counselors"; a computer specialist; a "processor", a receptionist/manager; and, three more in management. Managers sometimes performed phone operator duties. "Top management" is defined as EMP and BM-2. Phone operators communicated with the clients by telephone, to discuss the client's financial difficulties. The phone operators then generated a plan of action, and attempted to enroll individuals in a DMP.

For the years under examination, the following family members were employed by ORG.

Family Salaries & Wages

Total payments to family members and to related companies in 20XX was \$ or 77% of total expenditures of \$. Family members are salaried employees, and only family members were entitled to health insurance benefits.

ORG's hourly phone operators ("*counselors*") were paid 10% of total payments signed up for the DMP.

The application for exemption provided that there would be no annual compensation to BM-2 and other board members and officers from his family.⁴ The budget part of the application indicated amounts for payroll, but did not separately identify compensation for officers as required by the form.

Activities:

For the year 20XX, ORG handled over 61,426 telephone calls. Of these inbound calls 21,000 calls lasted up to twenty minutes in length. Of these 21,000 calls, 986 were recorded sessions lasting more than 20 minutes. Within these sessions enrolled in a DMP. In a conference with IRS examiners on 3/7/20XX, ORG stated that 98% of the time on calls by "counselors" was spent on educating. The other 2% of the operator's time was spent enrolling clients on a DMP. The 2% operators' time amounts to the ratio of the enrolled clients divided by the 21,000 inbound calls.⁵ ORG regards the balance of the 21,000 calls as counseling education.

⁴ See Item 4, Part II, of Form 1023 (page 3); See also Item 17, Part IV of Form 1023 (page 8) and the supporting budget attached to the application for exemption.

⁵ Response to IDR 9.

In the year under examination, ORG had _____ clients to account for in 20XX. ORG's policy requires that deposits are to be refunded within 30 days of the successful completion of the program as long as the client has paid on time, and has had no NSF or stop payments and has paid all listed debts on the program through ORG. ORG pays no interest on this deposit. Based on general ledger analysis of refunded deposits, there were _____ clients who had successfully completed a DMP. Total deposit refunds for these _____ clients were \$ _____; however the audit financial statements discloses \$ _____ of client refunds. Meanwhile, the 20XX database of clients shows _____ accounts to be paid in full in the same year. This accounts for a full success rate of 6.6% (_____ divided by _____).

ORG's DMP is a service for both individuals *and* creditors. ORG serves as a debt consolidation service by collecting monthly deposits from indebted clients, and immediately disbursing these funds to creditors. Proposal letters to creditors state, "*Our goal is to help the client repay the entire amount due to you.*" A DMP is a tool used to restructure unsecured debt, and to prevent clients from filing bankruptcy, as creditors do not collect on bankrupt debtors.

Under ORG's DMP process, a consumer signs a contract agreeing to make monthly payments to ORG. ORG then makes arrangements with the consumer's creditors to distribute payments to them. Creditors set criteria as to who is eligible for a DMP. Operators are not trained to determine when a DMP is appropriate. There are no formulae, computations, guidelines, rules, triggers, or other facts and circumstances used to determine whether a DMP is appropriate for a client.

Recordings showed that the DMP process was scripted. One employee was terminated for not following the script. Two employees were given warning notices for not following the verbal script.

For those customers who chose to participate in a DMP, ORG entered into "contractual recordings." For legal reasons, this was a part of the session that was recorded. In these recordings, ORG's operator identified himself/herself and their employer. The operator then confirmed the agreement to enroll into a DMP. Clients were sometimes told that the session was recorded for quality assurance purposes. The operator confirmed the date of the session and the identity of the client. The client then confirmed their identity by providing date of birth and social security number. The operator then confirmed the client's address and phone number(s). Clients were then told that the service was "consolidating" debt or credit cards, and the total debt was restated. Sometimes clients were told that ORG was a debt consolidation service. Operators confirmed that clients understood that credit card accounts would be closed and that the service was not a loan. Operators then advised clients of the security deposit amount, monthly deposits, and their respective due dates. They were then informed that the security deposit was refundable at the end of the service, unless clients forfeited the deposit by not completing the DMP. While restating the monthly deposit, clients were advised that ORG's \$ _____ monthly "donation" was included in the deposit. Clients were sometimes led to believe that the "donation" might be tax deductible. The operator then confirmed the authorization to draft funds, and the bank routing and account numbers. Operators then advised clients that the DMP packet would be furnished for the client to read and sign. Clients were then told to send (or fax) the agreement with attached creditors' statements back to ORG. Clients were then congratulated and welcomed into a program that would save them interest, fees or both. An enrollment number was then provided to the client.

Proposals were then issued to the clients' creditors. Proposals were either accepted or rejected by the creditor. Creditors maintained their own criteria regarding an acceptable proposal. If rejected, ORG must

resubmit the DMP proposal after reworking it with the client. Once accepted, ORG would proceed to collect the payments from the clients and make the regular disbursements to clients' creditors.

Clients in 20XX. IRS examiners requested electronic client records for all clients existing in 20XX with specific fields. The response to this request yielded electronic records. Among the data fields requested were the number in household, and the number of dependents, but almost all records had no data in these fields. A total of 40 records of the records contained number-in-household data.⁶ There were fewer computerized records containing the number of dependents. IRS examiners requested the following fields from the client database in IDR CAS 1, however, data from these fields were not provided:

- Age of client
- Fees
- Discounts/reductions in Fees
- Waiver of fees

There were 33 electronic records that showed a monthly fee, of which 11 showed a lower fee than the Normal fee of \$. All other records had no amounts in these fee-related fields. There were 12 records of clients with both social security checks *and* food stamps; however, there was no documentation of fees charged to these clients.⁷ The overall percentage of clients who were in their financial position due to a life crisis event is unknown because some records have no data; however, the data furnished is as follows:

Reasons for Financial Problems for Clients	# of Records	Pct
Reduced Income/Unemployment		64%
No Data [blank]		20%
Poor Money Management		10%
Medical Expense, Accident or Disability		3%
Personal Conflicts (Divorce or Separated)		2%
Not Classified/Other		1%
Death of a Family Member		0%
Total Records		100%

The electronic records did not present total expense budget of the client. Of the electronic records, 33 records represented clients receiving food stamps, but all others contained a blank field regarding the use of food stamps. 106 records showed clients receiving social security checks, but all other records contained a blank field for social security. Twelve records of the total records reflected clients who were receiving both social security *and* food stamps. There was no indication that these clients received a waiver or reduction of fees.

Examiner's Sample. Examiners then selected a sample of 38 DMP records from the DMPs using a random number generator, in order to review the paper files. Of this sample, the client's total expenditure-to-total income ratio (a measure of solvency of the clients) ranged from 38% to 120%. One file documented a lower monthly fee of \$ because the client was not pleased with the service.⁸ Of the 38 hardcopy DMP files, 23 did not provide the number in the household, though they stated the number of dependents. Most of the others stated the number in the household, but not the number of dependents. Five records had no documentation of both the number of dependents and number in household. At least three of the 38 records were senior individuals (64 or older), and two of these were within 200% of the HHS Federal Poverty

⁶ See *irs_clientinfo.xls* in response to IDR CAS 1

⁷ Clients #2225, 2231, 2250, 2310, 2855, 2924, 3089, 3246, 3418, 3471, 3488, 3493

⁸ Client #3476

Guidelines, but there was no indication that the fee was reduced or waived.⁹ There were five DMPs that represented clients relying on social security – and there was no indication that the fee was waived in these cases.¹⁰ Using HHS Federal Poverty Guidelines and U.S. Census Bureau Poverty Thresholds, one client was considered low-income, and a member of a charitable class – there was no indication that the fee was waived in this case.¹¹ One client was on food stamps and there was no indication the fee was waived or reduced.¹² There were eleven more clients (in addition to the two senior clients) who were within 200% of Federal Poverty Guidelines, but there were no reductions, sliding-scale fees, or discounts indicated.¹³

Five of the 38 sampled hardcopy files had no budget information for the client.¹⁴ For those files that contained budget information, “bring home” income was documented – there was no information on gross income and withholdings. None of the files contained information regarding assets owned, and there was no detailed description of automobiles, and terms of installment notes. The files contained no references or details as to employer fringes, healthcare coverage, retirement accounts, education level, lifestyle descriptions, skills, and hobbies. The ages and medical condition of dependents and children were not in the files. Almost all files contained no specific information on mortgages (other than the monthly payment). Of the 38 DMP records, 14 had no known cause for the client’s financial troubles.¹⁵

While all 38 files contained typewritten notes, the notes were primarily documentation of communications relating to utility matters of the DMP, such as accuracy of creditor information, follow-up on missing payments, unexpected increases in interest rates and creditor fees, adding creditors, adjusting payments, and similar items. None of these typewritten notes made references to areas counseled, referrals to specified government and non-profit agencies, educational materials provided, nor specific areas being counseled or taught. There were no references to informing clients of specific seminars, workshops and public educational events in any of the notes. ORG did not provide a list of specific agencies to its employees in order to assist them in referring clients with life crisis problems. There was no documentation of specific publications provided and reviewed with the clients. In all of the client notes from the sample, there was no mention of the company’s website as an educational source. There was nothing in the file that indicated whether the session was in-person, and there was no documentation of viable alternatives for the clients.

Of the 38 files, three DMPs were successfully completed; however, examiners could not identify the ultimate outcome of most of the others, as some were ongoing. Earlier versions of the budget worksheet in these folders contained 62 expense item fields. Later versions of budget worksheets used in 20XX contained 11 major expense categories with no documentation of details. Below is a breakdown of the sample of clients who were elderly, low-income, or unknown as to either of these characteristics.

⁹ Clients #3318, 2871, 3277

¹⁰ Clients #2847, 3318, 3277, 3355, 2517.

¹¹ Client #2979

¹² Client #3355

¹³ Client 3447, 1078, 1950

¹⁴ Client 1946, 1525, 2847 2308 2586

¹⁵ Client# 1774, 1946, 1525, 2847, 1560, 1078, 2170, 1770, 2796, 1686, 1950 2586, 2178, 2908

Breakdown of Sample Clients		
Clients within 100% HHS Poverty Guidelines		1
Clients within 100-200% of HHS Poverty Guidelines		13
Clients above 200% HHS Poverty Guidelines		17
Unknown		7
Total Sample		38
Total Clients Age 64 or Above		
(2 of which are within 200% of Fed Poverty Guidelines)		3

De-activated Records. In 20XX there were a total of 316 deactivated records. A deactivated record is a terminated DMP. Of that total, records indicated “*Client(s) have paid accounts in full,*” reflecting a rate of 27% (). However, a review of the accounting records showed 15 refunds of deposits, and of that 15, eight were not present in the list of 316 deactivated records in the “*Client(s) have paid accounts in full*” category. Audited financial statements for the year ended December 31, 20XX show that client refunds were \$; Client refunds due to successfully completed DMPs based on the general ledger was \$ for clients. According to contract provisions, a deposit refund is required to be made when a client successfully completes the DMP program by making all payments directly to ORG with no NSF’s and no stop payments. Below is a summary of De-activated DMPs in 20XX:

SUMMARY COUNT, De-Activated DMPs in		
Reason for De-activation	Count	Pct
[No Reason given]		37%
Client(s) have paid accounts in full.		27%
Client(s) have requested to be dropped from payment plan		21%
Bankruptcy		8%
Client(s) have been unable to follow plan		6%
Other		2%
Total Count of De-Activated DMPs in		100%

Other Information. ORG did not send or mail statements to clients that presented the status of their accounts. Only clients with computer access could view statements online.

ORG stated on its application for exemption on Form 1023 that it would conduct “*credit counseling and debt management.*” The statement of program service accomplishments on Part III of Forms 990 stated, “*The Organization provides credit counseling and debt management services to individuals who have had trouble managing their consumer and credit card debts. The service is offered in an attempt to educate these individuals on debt responsibility.*”

Fees and Fair Share

Almost all of ORG’s revenue is derived from the sale of DMPs. DMP revenue consisted of two components: client fees and fair share. Total fair share for the year ending 12/31/20XX was at least \$, or 63% of total revenue of \$. Approximately 90% of the funds are electronically transferred. There were no statistics on waivers or reduction of fees.

ORG solicited “fair share contributions” from credit card companies. The term “fair share” is actually a collection fee charged to creditors who are receiving payments pursuant to a DMP. Although fair share is voluntary and dictated by the creditors, creditors receive a valuable service in return for their fair share payments. Fair share is a stated percentage of debt, and the amount payable to ORG is determined in

advance by the creditors. ORG must meet certain guidelines and utilize certain electronic remittance organizations, or it will not be paid.

ORG charges consumers a monthly processing fee that it refers to as “donations.” The monthly fee charged to clients in 20XX was \$. Although payments were voluntary, clients received a valuable service in return for their payments. While there were no setup fees; an additional amount referred to as a “security deposit” was required up front. The security deposit was only returned to the client if the client successfully completed the DMP. See **De-Activated Records** on previous page. Security deposits were not separately disclosed on the return or on the audited financial statements. Note 4 of the audited financial statements provided that there were no contingent liabilities.

ORG charged a \$ NSF fee. ORG also charged a \$ add-on fee for each additional account not previously disclosed at the time of enrollment. ORG also charged a fee of 15% of any direct payments a client makes to a creditor. Some contracts are not specific as to the additional amount to charge. There was also a \$ fee if a payment was made without a name and client number on the payment itself.

ORG asserted on the application for exemption on Form 1023 that “[*Credit Counseling and Debt Management*] will be done free of charge with no maintance [sic] fees.” The application also stated that the company would be partially supported by religious organizations or other non-profit groups. The company also categorized fair-share as contributions in the application for exemption for purposes of the exemption and foundation classification. ORG’s letter dated July 31, 19XX in response to the IRS belief that the amounts received are sales, ORG stated, “*Since we have nothing to sell and rely on 100% voluntary donations, we believe we fit under the 509(a)(1) and not the 509(a)(2).*”

The audited financial statements refer to the sales revenue as “cash commissions.”

Training and Evaluations

ORG’s “Counselors” must have a high school diploma. Prior to 20XX ORG did not conduct background checks on employees, and not until 20XX did ORG began requiring applicants with financial, banking, or credit backgrounds. ORG did not announce job openings, but rather used a for-profit employment service , due to their experience with staffing ORG of City and their screening processes.

ORG trained employees by requiring them to observe 10 sessions, and then perform 10 supervised sessions. Employees were evaluated on whether they were able to sign the client up for a DMP, and if not, an explanation was required. Not all personnel files contained evaluations for the supervised sessions. For those that were available, the evaluation was limited to whether or not the client signed up for the DMP or not, and if not, a reason is stated. In other evaluations, productivity referred to DMP volume and the quality of sessions.

There was no consistency regarding the use of training materials for employees. One employee completed the “*BOOK*”, by Author. Another employee took an exam of 60 multiple choice questions on the *DebtGuard Financial Literacy Program*, which includes an examination several months after being hired. The course included:

- Section 1: Understanding Money Course (20 multiple choice)
- Section 2: Understanding Debt course (20 multiple choice)
- Section 3: Understanding Credit Course (20 multiple choice)

One employee took an internally devised study test with 30 multiple choice questions. The remainder of employees didn't have any specific educational accomplishments documented in their personnel file. In 20XX, new employees were also required to take the internal *online education course*, which was placed on ORG's website. Some files had no training evidence in them. Evaluations were not consistent. Within two weeks of being hired, employees conducted sessions with the public.

"Counselors" are not necessarily certified in 20XX. Only management level employees were certified by the CO-11 (CO-11), which was sponsored by the CO-12 (CO-12). Some employees were not independently certified until long after they were conducting sessions. For example, EMP-1 was hired on May of 20XX, and became independently certified on June of 20XX. Some employees had internally created certification forms in their files. There are no certified mortgage counselors, and ORG does not provide HUD counseling, nor reverse mortgage counseling.

ORG stated in its application for exemption that, "*This activity [credit counseling and debt management]...will be conducted by various individuals who have experience in the credit counseling field....*" The website in 20XX stated, "*ALL of our counselors are certified in credit and debt management.*"

Advertising

During the year under examination, ORG advertised in the yellow pages. Some clients were referred to ORG from the internet. However, the vast majority of clients are obtained by cold calling from the automatic telemarketing server. Calls to five states where ORG is permitted to engage in this activity. The five states are XYZ, XYZ, XYZ, XYZ and XYZ.

The website included the following advertising messages:

- Debt Consolidation Without A Loan
- Stop Creditor Hassles
- Payment Reductions (up to 50%)
- Reduce Interest (up to 100%)
- One Payment Debt Consolidation
- Safe Alternative To Equity-Loans Or Bankruptcy
- Bible Based Financial Seminars

Total telemarketing and advertising expenditures for 20XX was \$, which was 44% of total expenditures of \$. CO-2/CO-1's invoices refer to the service as either "calls" or "advertising."

20XX Totals

ORG's application for exemption stated that "*Most of our clients are referred to us from the area churches that see us as a ministry to help others. The local CO-4 bases have been sending us people and the CO-5 also...*" The budget provided with the application for exemption stated that advertising expenses would be \$, \$, and \$ for the first, second and third years of operation respectively, which amounted to 8%, 6% and 5% of total projected expenditures respectively.

Education

In the year under examination minutes to the meetings did not address the educational activities. All discussion was pertaining to DMP's, procedures for processing payments, client contracts, and internal controls. There was never a mention of an outreach education program. Education in the form of

counseling was only addressed in the context of obtaining the necessary and correct information to insure the client would qualify for a DMP.

With respect to the “*Bible Based Financial Seminars*” listed above, there were no lists of seminars or workshops to refer to. There were no statistics on the number of persons attending seminars and workshops, no attendance rosters, no lesson plans, no feedback and surveys, and no publicity of seminars and workshops. Online education didn’t start until after 20XX.

BM-2 stated to examiners that ORG conducted “many seminars” back in 20XX; however, there was no explanation why these seminars would have stopped. ORG claims to have had two educational projects in 20XX (Outreach Project #1 and Outreach Project #2). These projects included a total of four presentations; however, there was no evidence of specific objectives, lesson plans, PowerPoints, evaluations, feedback, surveys, names of attendees, number attended, reports, letters to sponsors, and material promoting the seminars to the public. These presentations were not advertised on ORG’s website, and there is no evidence of widespread notice of these events to the public. Phone operators labeled, “counselors” were not apprised of these schedules so as to keep the public advised. No lists of non-profit and government agencies were provided to any participants.

ORG began acquiring publications in 20XX.¹⁶

- 8 booklets provided at the CO-13 (CO-13) Center and provide presentations at no charge. ORG states that CO-13 is an organization that provides shelter and helps those who lost everything. ORG claims there was a 15 week program at the CO-13 shelter. There is no record of this program actually taking place.
- This is a \$ book that ORG claims to provide for free – a 12 chapter bilingual course. There is also a login for the course. The course is not required for clients, nor are the results graded and feedback provided by ORG. This program was not ordered until after August of 20XX.
- Newsletter that is given out in 8 complexes of the City Housing Authority.

The distributions of educational materials to clients started in June of 20XX. However, publications were not distributed to clients unless they asked for them.

- a. BOOK
- b. BOOK
- c. BOOK
- d. BOOK
- e. BOOK.

The Articles for Incorporation stated, “*Education will be provided to the client’s so they can avoid the same pitfalls in the future. This will be done through personal counseling, classes and seminars. We will also provide books, brochures, and audio and video tapes as necessary.*” ORG’s application for exemption further stated, “*Seminars will be offered to individual groups, churches, and schools...*” The budget provided with the application for exemption stated that income from seminars would \$ and \$ in the second

¹⁶ Per

interview

and third years of operation. ORG also stated, "*We do not only handle bills for people we also teach classes free of charge on how to manage your budget.*" The 20XX website stated that ORG would provide "*Bible Based Financial Seminars.*"

Website

The website doesn't present ORG's street address and precise physical location, and there is no posting of the hours of operation. The website does not disclose the identity of board members, the BM Family, nor who is the CEO of the company; and it does not inform the public that the return Form 990 is available for public inspection.

The "*Ask Yourself*" link is a one page bulleted list which includes the following:

"Are you:

- *Feeling like credit cards are dragging you down?*
- *Getting angry letters and phone calls from creditors and collectors?*
- *Contemplating bankruptcy?*
- *Gambling your future security on a home equity loan?*
- *Tired of high interest and just want to get out of debt?*

If So...Don't wait until you're drowning in debt! ORG Can Help!!! ALL of our counselors are certified in credit and debt management."

The *About Us* page advertises that ORG has *Certified Counselor Training*.

The *FAQ* page states, "*Debt Consolidation/Credit Counseling is the process of negotiating with all of your creditors to obtain the lowest monthly payment and interest as possible in order to pay off all your debt as soon as possible...While on the debt management you combine all of your payments into one low monthly payment, which is then disbursed to each of your creditors. In most cases this monthly payment is reduced by as much as 50% of what you are paying now!*"

Also the "*Educational Materials*" link on the homepage doesn't show up until 20XX. ORG did not track statistics on completion of online courses.

The *How We Can Help* page is a one page bulleted list of seven areas ORG will provide assistance:

- *Debt Consolidation Without a Loan*
- *Stop Creditor Hassles*
- *Payment Reductions (up to 50%)*
- *Reduce Interest (up to 100%)*
- *One Payment Debt Consolidation*
- *Safe Alternative to Equity-Loans Or Bankruptcy*
- *Bible Based Financial Seminars*

Return Information

ORG believes it was not necessary to disclose the related organizations on the return Form 990. All sources of support were categorized as direct public support on page 1 of Form 990 for filing and public disclosure purposes, and for foundation classification purposes on Schedule A.

Schedule A of Form 990 for 20XX, 20XX and 20XX, asks if during the year ORG has directly or indirectly engaged in certain transactions with officers, directors or board members, and their affiliated companies, including the furnishing of goods, services, or facilities. For all transactions other than compensation, the answer was "no" each time.

When reviewing minutes and comparing the board members to those listed on the Form 990, BM-3 was listed as a board member on the 20XX Form 990 after terminating her appointment during the prior year. Though BM-2 exercised substantial control and oversight over the company, he was not listed as a board member on the Form 990 until 20XX. If BM-8 was a director, he was omitted from the Form 990 prior to 20XX.

Below is a year to year comparison of return information:

TABLE

Memberships

ORG is a member of the CO-14 (CO-14). ORG also subscribes to _____'s international standards for quality management for purposes of securing fair share from creditors. In terms of quality, ORG states in its website, "*In order to assure high standards of service, ORG has achieved certification from _____ . Accreditation is a rigorous review of operating practices with an external body that measures effectiveness in delivering quality, professional service.*" _____ standards and policy manuals were provided to examiners, but these were ineffective for a small family-run company and never actually incorporated within ORG's operations. These standards were required in order to assure creditors that the company was operating within established operational guidelines so that ORG can remain eligible to receive fair-share.

LAW:

Section 501(a) of the Internal Revenue Code (IRC § 501(a)) provides that an organization described in section 501(c)(3) is exempt from income tax.

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

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in section 501(c)(3), 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.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945).

Treas. Reg. § 1.501(c)(3)-1(d)(2) 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.

Treas. Reg. § 1.501(c)(3)-1(d)(3) provides that the “educational” refers to:

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

Educational or Religious Activity Furthering Commercial Business Purposes

Treas. Reg. § 1.501(c)(3)-1(e)(1) 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 found that the trade association had an “underlying commercial motive” that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analysis 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. The Court concluded, however, that 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 more indicative of a business than that of an educational organization. The Court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and that the organization was not entitled to be regarded as exempt.

In Easter House v. United States, 12 Ct. Cl. 476 (1987), *aff’d* 846 F.2d 78 (Fed. Cir 1988), the Court found that adoption services were the nonexempt primary activity of the organization. In deciding that the organization conducted adoption services for a business purposes rather than for a charitable purposes, the Court considered the manner in which the organization operated. The record established a number of factors that characterize a commercial activity and reflected that these factors were evident in the operations of Easter House. 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; and 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 Scripture Press Foundation v. United States, 285 F.2d 800, (1961), *cert. den.*, 363 U.S. 985 (1962), a separately organized publishing corporation sold a large volume of religious literature, periodicals, and Sunday school supplies at a substantial profit was held not exempt. 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 character of the operation was that of a commercial publishing house catering to religious customers. Thus, the court concluded it was a trade or business and not exempt.

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 Fides Publishers Association v. United States, 263 F. Supp. 924 (N.D. Ind. 1967), a corporate publisher of religious books priced at commercial levels that showed moderate but consistent operating profits was held not to be exempt. The court said that although the “publishing activities further the exempt purpose of educating the lay apostolate,” nevertheless, there was a substantial nonexempt purpose— “the publication and sale of religious literature at a profit.”

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7 th Cir. 1991), the Court of Appeals upheld a Tax Court decision, T.C. Memo. 1990-484, that an organization operating restaurants and health food stores in a manner consistent with the doctrines of the Seventh Day Adventist Church does not qualify under IRC 501(c)(3). The court found substantial evidence to support a conclusion that the organization's activities furthered a substantial nonexempt purpose, including;

- a. The organization's operations were presumptively commercial;
- b. The organization competed directly with other restaurants and food stores;
- c. The organization used profit-making pricing formulas common in the retail food business;
- d. The organization engaged in a substantial amount of advertising;
- e. The organization's hours of operation were competitive with other commercial enterprises; and
- f. The organization lacked plans to solicit donations.

Counseling and Education

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 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (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 (free marriage counseling); 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, and the organizations were supported by contributions from the public.

Rev. Rul. 69-441, 1969-2 C.B. 115, granted exempt status under section 501(c)(3) to an organization with two functions: it educated the public on personal money management, using films, speakers, and publications, and provided individual counseling to “low-income individuals and families.” As part of its counseling, it established budget plans, *i.e.*, debt management plans, for some of its clients. The debt management services were provided without charge. The organization was supported by contributions primarily from creditors. By virtue of aiding low income people, without charge, as well as providing education to the public, the organization qualified for section 501(c)(3) status.

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 44 A.F.T.R.2d 78-5052 (D.D.C. 1978); 78-2 U.S.T.C. Para 9660 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b). The Court held that an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption

from income tax because its activities were charitable and educational. The Consumer Credit counseling Service of Alabama is an umbrella organization made up of numerous credit counseling service agencies. These agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they did provide such services free of charge. As an adjunct to the counseling function, they offered a debt management plan. Approximately 12 percent of a professional counselor's time was applied to the debt management plan as opposed to education. The agencies charged a nominal fee of up to \$10.00 per month for the debt management plan. This fee was waived in instances when payment of the fee would work a financial hardship. The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from service fees. The Court 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.

See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

Impermissible Private Benefit

Section 1.501(a)-1(c) of the Federal income tax regulations ("Treas. Reg. § 1.501(a)-1(c)") provides that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization. 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).

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his/her family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the "est" body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit

because the organization “was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations.”

In International Postgraduate Medical Foundation, T.C. Memo. 1989-36, one individual controlled both a nonprofit that ran tours aimed at doctors and their families and a for-profit travel agency that handled all the nonprofit’s tour arrangements. The non-profit spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The tours were standard sightseeing trips, with little of the alleged medical education that was the basis for exemption. The Tax Court held the petitioner was not tax exempt, finding that it was operated for the benefit of private interests, namely the founder’s travel agency. The court found that a substantial purpose of the nonprofit was to increase the income of the travel agency. (In this case there was both inurement and private benefit.) Also, its activities were directed at providing opportunities for recreation, not education.

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), bingo games were conducted by a scholarship fund in a commercial establishment serving food and drink, and were found not to be operated exclusively for exempt purposes. The owners of the establishment, Pastime Lounge, Ltd. (P.L.L.), controlled the organization and allowed players to be solicited for food and drinks sold by their employees. The court stated, that a realistic look at the operations of these two entities (the P.L.L. and the Pastime lounge), however, shows that the activities of petitioner and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accounting of receipts and disbursements does not change that fact.

GOVERNMENT’S POSITION:

Based on the examination and the analysis of sample client records, ORG is a debt consolidation service receiving “cash on commissions” (fair share) on the sale of “debt management plans.” It is not a credit counseling agency. An examination of the client files revealed that ORG was only interested in basic data sufficient to enroll a client in a DMP. Sessions were short and scripted and phone operators were not necessarily certified or experienced counselors when conducting their sessions. Phone operators were partially compensated on the basis of DMP enrollments. They were also evaluated on their ability to sell DMPs. There was no reliable record of face-to-face counseling. The organization made it very difficult for the public to identify its location.

ORG had a stated goal of serving the interests of the creditors. The creditors dictate the criteria for qualification into a debt management plan which serve their commercial interest. ORG provides for no intervening criteria in order to ensure that clients qualifying for DMPs are provided other options in the clients’ best interests. ORG also benefits the interests of the BM Family more than incidentally. ORG’s exempt status was exploited to initiate new businesses and to test the market for the telemarketing business prospects of the BM Family. BM Family businesses provided flow-through income earned from ORG to the BM Family, such as through various family owned partnerships. ORG was in effect a mass dialing telemarketing company. The existence of the related companies jointly involved in this business was not disclosed to the public, such as through Form 990.

In the acquisition of the dialing servers in 20XX, ORG did not acquire a fair appraisal of the property which was owned by a corporation controlled by family members. The cost of these assets were not more than \$ on CO-2/CO-1’s books, but ORG paid \$ for them. The excess benefit to CO-2/CO-1 was at least \$, assuming no depreciation of these assets. With depreciation the excess benefit is higher. The non-family board members who participated in the decision to purchase this property did not question the excess payment.

Educational activity was practically nonexistent. There were virtually no workshops, speeches, presentations, seminars or other media for presenting educational information. There was no meaningful public outreach program. The website was not elaborate with educational information. Publications were not distributed to all clients or callers during the year of audit. ORG possessed no educational facilities open for the public.

The Service relies on the information furnished to it during the application for exemption and foundation follow-up processes in order to grant exemption and public charity status. Critical issues represented by ORG during its determination processes were compared to actual events per examination as follows:

TABLE

The application for exemption does not inform the Service that the nature of the income to be received was commonly referred to industry-wide as, "Fair share". The audited financial statements refer to the sales revenue as "cash commissions." The application for exemption misled the Service of ORG's character, method of operations and intentions.

Annual returns on Forms 990 also never characterized and labeled the income for what it was: fair share. The Forms 990 consistently disclosed misleading information. ORG presented the following misleading information:

- Part VI, Line 80 failing to disclose related organizations
- Schedule A, Part III disclosing that there were no transactions with businesses owned by Officers & Directors
- Classifying all income as contributions on Part I and on Part VII for foundation classification purposes.

In all cases clients were misinformed that all their payments were contributions. In some telephone sessions, clients were led to believe that their payments to ORG were deductible as charitable contributions.

In contrast to the lack of educational activity, advertising was ORG's highest non payroll budgeted item at 44% of total expenses. Advertising was conducted by dialing servers sending telemarketing messages in mass, also known as "cold calling." The messages were commercial in nature, such as "Call us Today", "Call Now". On the website, messages such as "Lower Your Interest Rates!!! Sign Up Today!" were posted.

Regarding the actual conduct of debt management plans, there was no regard for poor, elderly, and persons with special needs in telephone sessions. There was no effort to furnish discounts, sliding scale fees or free services for debtors of a charitable class. There was no attempt to identify who would constitute a charitable class, such as by using HHS Federal Poverty Guidelines or U.S. Census Bureau Poverty Thresholds. While the database had the ability to track clients on food stamps and social security, not all clients were asked if they had food stamps or whether they were on social security. ORG did not have an established policy or procedure to waive or reduce the fees for the indigent or to waive the fees for those to whom such fees would create financial hardship. Only clients with computer access had access to their DMP statements. Also paper files failed to identify the specific causes of the client's financial position. Assets such as automobiles were not identified and analyzed for clients. Client files contained case chronologies documenting contacts with clients; however, these records never documented specific matters counseled.

Only matters of utility value were documented, such as adding creditors, missed payments, and changes to creditor's terms. Information about the client's lifestyles, financial assets, obligations, jobs and other relevant data to provide for a meaningful counseling session were not requested. ORG only acquired enough information to qualify clients for a DMP. ORG provided very little counseling to individuals on credit or debt management issues, and to the extent any counseling was provided, it was incidental to ORG's purpose of selling DMPs.

Below is a table of comparison of key factors in order to distinguish ORG from CCCS of Alabama which retained its exempt status in Consumer Credit Counseling Service of Alabama, Inc. v. United States, 44 A.F.T.R.2d 78-5052 (D.D.C. 1978):

TABLE

ORG is not operated exclusively for educational or for any other exempt purposes within the meaning of section 501(c)(3) of the Code. ORG's primary purpose is the sale of debt management plans. ORG also operated for the private benefit of its creators within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). ORG's exemption under section 501(c)(3) of the Code should be revoked effective January 1, 20XX. Misleading information to the public on Forms 1023 and 990 and characterizing its income as contributions to the public is indicative of an organization that is not educational for section 501(c)(3) purposes. ORG is a family run business, and the inclusion of outsiders in the board of directors was no more than for purposes of perception. Outsider board members possess no real power and authority over ORG.

Any claims of quality of service, good communications, trust, sensitivity and customer service are neutral factors as for-profit businesses have the same goals.

TAXPAYER'S POSITION:

At the time of issuance of the report, no position statement had been provided by the organization. Except that Part VI, Line 80 of Form 990 does not list related organizations because family members did not have control of the board of directors. The Power of Attorney (POA) now asserts that the organization has taken action to dissolve and distribute its assets and should not be revoked of its exemption under § 501(c)(3) since it will no longer exist. The POA further asserts the organization does not want to incur any additional costs in connection with the examination.

CONCLUSION:

ORG is not operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3).

ORG had the substantial nonexempt purpose of providing debt management program services to the general public.

ORG was operated for the purpose of serving private rather than public interests.

ORG's exemption under section 501(c)(3) should be revoked effective January 1, 20XX. The State of XYZ should be notified of this revocation under section 6104(c) of the Code. ORG is liable for tax returns on Forms 1120 beginning with the tax year ending December 31, 20XX.

ORGANIZATIONAL STRUCTURE

TABLE

A = BM-2, husband to I
 B = BM-1, son to A&I
 C = BM-7, son-in-law to A&I
 D = cousin to B, husband to M; Manager & Key Employee
 E = BM-8 (of;)
 F = Realtor (of Realty)
 G = BM-5, VP Banking (of)
 H = (of)
 I = wife to A (former BOD)
 J = daughter to A&I (former BOD)
 K = Father-in-law (deceased) to B (former BOD), sales with
 L = wife to B
 M = wife to D, Manager and key employee
 N = daughter to
 O = daughter to

1 = Director
 2 = Partner/Shareholder
 3 = Officer
 4 = Key Employee
 5 = Former Directors
 6 = Former Employees

Note: Highlighted individuals are family members
 Denotes service performed for ORG
 Denotes cash flow

Internal Revenue Service

Department of the Treasury
55 N. Robinson, MS: 4900-OKC
Oklahoma City, OK 73102

Date: April 29, 2008

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination