



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: August 5, 2008

Number: **200851024**
Release Date: 12/19/2008

UIL: 9999.98-00

EO

LEGEND

ORG = Organization name XX = Date Address = address

ORG
ADDRESS

Person to Contact:

Badge Number:

Contact Telephone Number:

Contact Address:

Employer Identification Number:

Deadline to Petition Tax Court:

November 3, 20XX

CERTIFIED MAIL

Dear _____ :

This is a final notice of adverse determination that your exempt status under section 501(c)(3) of the Internal Revenue Code is revoked. Recognition of your exemption under Internal Revenue Code section 501(c)(3) is retroactively revoked to January 1, 19XX for the following reason(s):

You have not been operated exclusively for an exempt purpose as required by Internal Revenue Code section 501(c)(3). You have not demonstrated that you primarily engage in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) as required by Treas. Reg. section 1.501(c)(3)-1(c)(1).

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

Since your exempt status has been revoked, you are required to file Form 1120, U.S. Corporation Income Tax Return, for all years beginning on or after January 1, 20XX.

Income tax returns for subsequent years are to be filed with the appropriate Service Center identified in the instructions for those returns.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia before the (ninety-first) 91st day after the date that this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. To secure a petition form from the United States Tax Court, write to the following address:

Please understand that filing a petition for a declaratory judgment under IRC section 7428 will not delay the processing of subsequent income tax returns and assessment of any taxes due.

The last day for filing a petition for declaratory judgment is November 3, 20XX.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call and ask for the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in 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.

This letter should be kept within your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Vicki L. Hansen
Acting Director, EO Examinations

Enclosures:
Publication 892

Internal Revenue Service

Department of the Treasury
Attn: Michael A. Ross MS 4900 TEM
Internal Revenue Service - EO
40 West Baseline Rd. Suite 214
Tempe, AZ 85283

Date: January 17, 2008

Taxpayer Identification Number:

Form:

ORG
ADDRESS

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

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (ORG)		Year Ended Dec. 31, 20XX & Dec. 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State Address = address
 motto = motto City = city POA = POA Secretary = secretary Attorney = attorney
 EMP-1 = 1st employee BM Family = BM Family CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7, CO-8, CO-9, CO-10 & CO-11 = 1ST, 2ND, 3RD, 4TH, 5TH, 6TH, 7TH, 8TH, 9TH, 10TH & 11TH COMPANIES
 BM-1, BM-2, BM-3, BM-4, BM-5, BM-6, BM-7, BM-8, BM-9, BM-10, BM-11, BM-12, BM-13, BM-14 & BM-15 = 1ST, 2ND, 3RD, 4TH, 5TH, 6TH, 7TH, 8TH, 9TH, 10TH, 11TH, 12TH, 13TH, 14TH, & 15TH Board Members

FACTS:

(A) Background – Exempt Status

ORG¹ (ORG) was incorporated on April 2, 19XX in the state of XYZ. ORG received their final determination letter from the Internal Revenue Service in June of 19XX. ORG was originally organized as the company outreach of BM1 and BM-2 specifically to:

- Develop a program of education in the Christian religion and to foster and promote the furtherance of Christian knowledge and belief among all men;
- Disseminate the Gospel by any and all means;
- Establish and operate centers to provide spiritual and moral guidance and all forms of assistance;
- Establish and operate vocational and/or bible schools;
- Train and support personnel for the operation of such centers, and to train and support religious workers to carry out the programs established by the corporation;
- Establish a center for religious education and worship;

From 19XX until 19XX, ORG owned and operated a Christian Motto in City, XYZ. They have also stated, among other things, they provided other Christian outreach programs in the United States and abroad, such as distributing bibles in Country and Country; providing medical supplies to people in Country; and providing humanitarian assistance to the needy in City and throughout the NW United States. ORG Country (19XX) and CO-1 (19XX) were incorporated in Country to start a Motto and provide an outreach in Country.

In 19XX, ORG began offering consumer credit counseling and MOTTO to the general public. In 20XX, ORG started its “CO-2” company to reach young adults and to provide them with a way to express their Christian beliefs; selling clothing and other items with the “CO-2” logo as a way to start conversations about Christianity. In 20XX, they started an outreach in City, Country and in 20XX they have begun an outreach in a rural community in Country.

¹ They were originally incorporated in 19XX with the name ORG, but it has legally been changed and is currently ORG.

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The primary concern we have with ORG is its credit counseling operations, as explained in more detail later. In the simplest terms, a key issue will be whether these operations were educational or if they were primarily set up to sell MOTTO (MOTTO).

A MOTTO is a tool used to restructure unsecured debt. Restructuring debt through a MOTTO allows a consumer to consolidate unsecured debt; ostensibly lower his/her interest rates and monthly payments, obtain re-aging of his/her debts, and/or curtail collections calls, penalties and over-limit fees. Typically under a MOTTO a consumer signs a contract agreeing to make monthly payments to a debt management agency, which then makes arrangements with the consumer's end-creditors and distributes payments to them.

(B) Board of Directors, Officers and Key Employees – Management Structure

ORG's incorporators and its first Board of Directors consisted of BM-1, BM-3 (BM-1's son), BM-4 (BM-1's son-in-law), BM-5, and BM-6.

The earliest documents provided by ORG on the board of Directors during this audit were Board minutes from 3-8-19XX, showing the board consisting of BM1 and BM-2, BM-7 (BM-1's daughter) & BM-8, BM-9² (BM-1's daughter) & BM-4³, and BM-10.

As of 4-25-20XX, the Board consisted of BM-1 & BM-2, BM-7 & BM-8, BM-9 & BM-4, BM-10, BM-11 (from XYZ), and BM-12 (from XYZ). Up until August of 20XX, the BM's Family members controlled the board of directors.

In March of 20XX, BM-10 requested a conference call with the remainder of the Board of Directors (at that time the BM's Family members), explained his position with CO-3 in relation to ORG and then resigned as a board member. The Board (still the 6 family members) accepted his resignation because of potential conflicts of interest on December 31, 20XX.

ORG stated in their letter of May 7, 20XX that BM-10 was a board member of ORG from August 11, 19XX to December 17, 20XX.

Shortly after BM-10 resigned from the board, until November 25, 20XX, BM-15, a key employee of the back office service provider, was also a board member of ORG.

A spreadsheet, attachment 1, shows how the board transitioned from 19XX to its form at the end of

² AKA, BM-9 or BM-9.

³ AKA, BM-4, BM-4, or BM-4

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20XX, as shown on ORG's Form 990. This return shows the board consists of BM-2, BM-7, Accountant (ORG's accountant), BM-13 (a local), and BM-14 (a local).

The Forms 990 show that during the audit period, BM-1 is the President and BM-7 is the V.P., Secretary, and Treasurer of ORG, except in 20XX Secretary took over as the corporate Secretary.

Minutes

ORG provided board minutes from March of 19XX to September of 20XX for review. The following chart shows what items were discussed and the number of times they were brought up over the time period above. Finally, the chart shows the percentage of time each item was brought up.

TABLE DELETED

Noticeably missing from the board minutes are discussions on any "education" actually provided by ORG's credit counseling activities or any of the "education" provided by CO-3. The board minutes also do not indicate that ORG has considered or approved any items related to the contracts it held with CO-3, which ORG confirmed in writing.

(C) Transition from a company to a Credit Counseling Agency

As stated above, ORG originally started as the company of BM1 and BM-2. For two decades it owned and operated a Christian Motto in XYZ. It also had numerous outreaches that continue today and other outreaches that have expanded.

In 19XX, ORG started its consumer credit counseling activities. Since prior to 19XX ORG had no experience with credit counseling, they contracted with CO-4 (CO-4) to conduct substantially all services related to their credit counseling activities.

BM-10 has been CO-4's CEO, President, Secretary, Treasurer, and Director since it was formed in July of 19XX. CO-4 is an S-Corporation and BM-10 is its sole shareholder (100%). While not a shareholder, EMP-1 helped to form CO-4.

In May of 20XX, while CO-4 was providing services to ORG, BM-10 formed an LLC, CO-5 (CO-5). CO-5 continued to provide credit counseling services to ORG, while leasing employees from CO-4. The members of CO-5 include CO-4 as the managing member, BM-10 as a 60% share member, and the BM-10 Family Trust as a 40% share member. Most of the funds from the BM-10 Family Trust flowed to EMP-1.

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CO-4 and CO-5 will be referred to as the Back Office Service Provider⁴ (CO-3). Therefore, CO-3 is the entity, in whichever form, in whole or in part that ORG contracts with to perform its credit counseling services.

CO-6 and CO-7 are claimed dba's for ORG⁵. CO-6 will refer to both, but we will use this term sparingly to avoid confusion. It will generally only be used in quoting items from materials reviewed for the audit. We must be mindful that the CO-3 often uses the term CO-6 or CO-7 in conducting ORG's credit counseling operations, so sometimes they blur the line between CO-6 referring to a dba of ORG and actually referring to themselves. Therefore, the term CO-6 must always be taken in context.

In terms of dollars, ORG's credit counseling activities have over the last few years become its primary activity. The following chart shows income from different sources as reported by ORG on its Forms 990:

From the above table, we can see the progression of revenues received from the credit counseling operations; it is clear that the credit counseling operations now represent substantially all of ORG's income.

In terms of the number of workers paid, and the amounts paid as wages, to conduct ORG activities, ORG's credit counseling activities have over the last few years been its primary activity. The following chart provides detailed information showing the relative importance workers and wages in ORG's operations.

In addition to paid workers, ORG has claimed that they rely on a substantial amount of volunteers to perform their exempt purposes. ORG has provided some documentation to show volunteers did provide some services, but nothing to show actual hours worked. They also verbally provided information about several individuals who performed missionary work for them in other countries, but again nothing to show actual work for comparison purposes.

ORG did not provide information to suggest that the volunteer labor hours were comparable or even significant to the labor hours of between 600 to almost 900 full time workers employed in their credit counseling operations (These numbers are total workers and includes turnover in those operations.) ORG believes there may have been at most about 450 workers working at any one time.

In information document request # 8 dated February 8, 20XX; we asked ORG whether credit

⁴ We were unable to use the term CO-6 to refer to the CO-3, because this was the dba for ORG's credit counseling operations.

⁵ Per the

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counseling was either their primary activity or a substantial activity. They stated if the credit counseling activities are attributed to ORG, credit counseling would have been ORG's primary activity during 20XX and 20XX from the standpoint of income, expenses, wages paid, and hours worked. ORG has agreed that CO-3 served as its agent during the years at issue; trusting CO-3 to conduct the credit counseling activities in a manner that was educational and otherwise qualified under section 501(c)(3)."

(D) Credit Counseling Operations

In this section we will discuss how ORG attracts and obtains clients, how they conduct the initial counseling sessions or the intake process, and other contacts made with the credit counseling clients. We will then discuss hiring, training, evaluating, and compensating the individuals performing these functions. We will then cover other claimed educational activities.

Obtaining Clients

Pursuant to the contracts, CO-3 is responsible for obtaining the credit counseling clients. This includes all advertising, marketing and purchasing of leads. CO-3 obtained clients for ORG operations primarily from Advertisements and from purchasing leads. Additionally, CO-3 provided a statement that they received approximately 7% of their clients from the operation of their website.

While ORG has indicated they used TV, motto, and Print advertising, they only provided documentation of the TV advertisements, although they were asked to provide information on all advertising⁶. Additionally, we are not sure of the amounts of leads purchased, as ORG claimed to be unaware of CO-3 actually purchasing leads and CO-3's only comment on this subject was that ORG did not pay for leads or lists. The service provider did not clarify the amount of lead purchases on their part.

Advertising

ORG provided copies of 28 commercials that CO-3 had created in order to attract customers. While these commercials were used during 20XX and 20XX, they were produced starting in Sept of 20XX, up to May of 20XX. Every commercial was reviewed⁷.

⁶ Information Document request 8, Item 7.

⁷ We took notes during all the commercials, including some verbatim transcriptions of the commercials.

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Out of the 28 commercials, 19 of the early commercials, 4 commercials from 20XX; 5 commercials from 20XX⁸, and then 10 in 20XX, promoted the MOTTO only. The different commercials would contain comments from debtors about how they got into debt and/or how it was negatively affecting their lives. A CO-6 Rep.⁹ would then explain how CO-6¹⁰ would help them through the benefits of a MOTTO. This was the sole purpose of the commercials. Three of the four commercials produced in 20XX, that ORG provided as being used during the audit period, indicate that “in as little as 15 minutes” callers will be “on their way to financial freedom”.

Chronologically, the next 4 commercials were produced on 12-11-XX. These are the first commercials that mention that CO-6 offers anything in addition to the MOTTO to clients. In this case they mention that CO-6 can give the clients “so much helpful information about getting out of debt as well as free online educational materials about managing their finances.” However, when the commercial describes the services, the commercials states, “First, they ran a debt analysis to see if they could save us money before we signed up.” They then describe the MOTTO benefits. After indicating that CO-6 set them up on a MOTTO, which they refer to as an “affordable payment plan”, the client states, “they even gave us advice on budgeting our money so this wouldn’t happen again.”

We believe the most favorable¹¹ commercials at this time are the one minute long versions created on 12-11-XX, and specifically the one from Spot Logic entitled “Testimonials”. When we transcribed this commercial, we had 19 full lines of text. From this amount 13 lines of text specifically talk about how CO-6 assists callers¹². About 67% of those 13 lines described the MOTTO vs. 33% describing information, education, or budgeting advice¹³. Overall looking at the general feel and emotional plea of the commercial, they are appealing to people that are in debt and want to be put on a MOTTO to receive all the MOTTO benefits. Therefore, based on prominence and relative amount of time devoted to MOTTO, the commercials clear primary purpose is to promote the MOTTO.

The newest commercials used during the audit period were produced in April and May of 20XX. In these commercials, neither the clients nor the CO-6 Reps mention anything outside of the MOTTO that CO-6 would use to help the clients. However, during most of the commercials, at the bottom of the screen in clear and easy to read print is the following statement, “Call for free educational materials and resources”. Since the entire dialogue is about the MOTTO and its benefits, that is obviously the purpose

⁸ One was in Spanish.

⁹ An actor portraying a CO-6 Representative.

¹⁰ CO-6 in the advertising would seem to imply the dba for ORG, although of course the actual contact point would be an employee of CO-3.

¹¹ Favorable in this case meaning representing a commercial indicative of an educational organization.

¹² The remaining 6 lines are neutral items introducing or promoting CO-6.

¹³ The 30 second commercials created at the same time, devoted less time to educational issues and more time to describing the MOTTO and its benefits as a percentage of the total commercial.

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of the commercial. Since the educational aspects are never mentioned, it makes it seem as if it is something else that they do.

Website

In addition to the fact that CO-3 claimed they obtained 7% of their clients from their website, it is also a general source of information about CO-6 and its operations. Since the audit period covers two years, and web pages generally change over time, we decided it would be relevant to choose to look at their website at the beginning of the period in the middle and towards the end of the audit period¹⁴.

We obtained the web pages in existence during the audit period from an internet archiving service. Portions of these web pages were provided to ORG with document requests, with a request for comments. Therefore, they are part of the administrative record.

In reviewing the website, our concentration was “What is the primary focus of the website, based on visual prominence and relative amount of time and space devoted”? Also, are MOTTO mentioned as only one possible option for addressing debt problems or are they one of many options presented to readers?

To do this, we looked at the homepage and we looked at the links associated from this page. Starting with the homepage, the largest print and the first thing that grabs the viewer’s attention is the statement “I finally have a plan.” Under this attention grabbing caption, the homepages all have similar statements to: “If you’re committed to getting out of debt, we offer a plan to pay off your balances in five years or less, so you can stop worrying and get on with life.” Under this, it states, “SEE HOW MUCH YOU CAN SAVE”, and they provide a link to a savings calculator.

The homepage continues with banners and links calling for action such as enrolling or calling CO-6 for more information. There are also numerous links providing additional information on MOTTO. These links are similar to links that would be on any website offering services, such as describing who the company is, what they do, and like many websites, this one contains a list of FAQs. With few exceptions, all of this information is concentrated on some aspect of the MOTTO.

On the bottom portion of the homepage, there is an area describing financial education along with links to other educational information. This area changed the most over the audit period. The earliest pages reviewed provide one quick sentence and a link to Read Expert Advice. In the last, there are four

¹⁴ If we didn’t limit our review, we would have to look at 12 different updates in 20XX and up to 23 updates in 20XX, with the related links. As the changes were not that great, we believe the review was more than sufficient; providing an accurate depiction of the website for the audit period.

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sentences, with 4 links to 3 different destinations¹⁵. While this area of the webpage indicates that education is a key ingredient, a correct reading shows it is actually indicating this is a key ingredient of a MOTTO.

Additionally, on the links, CO-6 provides a description of who ORG is and what they do. Over time, the website puts more and more emphasis on the education provided by ORG. However, it is generally done in the context that the person would be on a MOTTO. The Terminology used simply indicates debtors will be helped by an active plan, without mentioning a MOTTO or inferring the benefits of a MOTTO. By the last version, the message here is that education is the primary activity and that they have helped tens of thousands with their plans.

As stated earlier, the website contains links¹⁶ to various educational items. In the early versions, these linked to informative articles. Some of the articles, in addition to providing information, promote CO-6 and/or getting on a MOTTO. In later versions of the website, they included links to more educational articles and other websites that provided educational materials. As additional pages were added to the website, they also placed on some of the ancillary pages, information on other social services.

While we have mentioned the informational and educational aspects of the website, it is clear that the emphasis of the website is the MOTTO. Starting from the homepage, the most prominent items are related to the MOTTO and most of the links from the homepage discuss the MOTTO. Even some of their informational articles promote the MOTTO and working with CO-6 to get on a MOTTO.

Intake Process

As part of the marketing service ORG contracts for, CO-3 then provides intake services. While the April 11, 20XX amendment indicates ORG was to perform these services after that date, ORG has indicated that “when the CO-5 counselors were technically transferred to the ORG payroll, the counselors remained under the substantive direction and control of CO-5, and the manner in which they conducted their credit counseling activities remained substantially the same.”

ORG was not able to provide recordings or other contemporaneous documentation to support the counseling process, much less the remainder of the counseling process. To document the counseling process in general, ORG provided copies of scripts required to be used by counselors. These scripts provide an indication into how the intake process operated.

¹⁵ The first two links provide a link to the same website.

¹⁶ These links may require one or more links to get to the actual educational or informational item.

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ORG has provided numerous scripts evidencing their counseling process. Again, although they were asked¹⁷, ORG did not provide any type of flow chart to indicate when each script was used. A detailed review of these scripts is included as Attachment 2 and the scripts themselves are part of the Administrative Record; we will summarize the attachment below.

ORG provided numerous versions of the scripts. For the initial counseling calls (the intake calls), there are basically 3 generations of scripts, the others are subtle and immaterial variations on those. The 3 generations started on 11-26-XX, 8-15- XX, and 4-15- XX. The first two generations are obviously keyed towards MOTTO, as education and financial information is none existent. They have absolutely no positive factors to indicate any education was attempted.

The last generation of scripts reviewed and which were used during the audit period, were changed markedly from prior versions. However, they still appear to be keyed towards the quick identification of potential MOTTO clients and the rapid dismissal of clients not interested in signing up for a MOTTO. The last version, effective the last month of 20XX, does refer callers to websites they describe as "very educational" before the calls are ended. However, it doesn't appear the actual intake process is part of an educational activity.

The scripts ORG provided are the best documented evidence of how ORG operated its counseling operations. They provide no documentation of asking for full financial information, discussing budgeting or finances, employment, education, buying habits, significant expenditures, or any significant past or anticipated changes in their earnings, assets, expenses and liabilities, including the reason or cause for those changes. The scripts do not document that options and strategies are developed based on a callers circumstances, they are primarily geared to putting callers on MOTTO as a method to help them get out of debt.

Furthermore, the scripts are biased to discuss the advantages of MOTTO and the disadvantages of any alternative mentioned as part of a sales technique to sell MOTTO. Granted, if the person will not qualify for a MOTTO, the script does then offer very quick suggestions to the callers. Finally, the scripts generally do not direct the sales reps to provide referrals for other support services.

Other Contacts with Clients

ORG has provided numerous other scripts used in their operations. However, after the initial call¹⁸, all the scripts pertain only to the MOTTO. These scripts are used for MOTTO package reviews, enrollment verifications, and general call verification. There are no educational elements, except for a possible closing statement mentioning their website.

¹⁷ Information Document request 8, Item 13.

¹⁸ The "initial call" may actually be accomplished in one or more calls, depending on circumstances.

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ORG provided listings of the “manuals” used by CO-3 in conducting the credit counseling operations; these contained the scripts used by CO-3. ORG could provide no information or documentation to show that there were any educational contacts made, after the clients were set up on a MOTTO.

“Counselors”

First, we want to discuss the term “Counselors” briefly. We have used this term because this is the common term used in the industry. In this context, this simply means these are the individuals hired to talk to people on the phones in ORG’s credit counseling operations. It should not be deduced to mean the “counselors” have any specialized knowledge obtained through years of college level education. It is also not a comment about their education, training, abilities, or their jobs; it is simply a title.

In fact, on many of the scripts they refer to these individuals as “Sales Reps”. These individuals were called Sales Reps up until Feb. of 20XX; so for the majority of the audit period the employees using the initial counseling session scripts were called Sales Reps. Therefore, these terms can be legitimately interchanged and essentially mean the same thing with respect to ORG’s operations.

Hiring and Job Requirements

In the early contracts ORG has with CO-3, CO-3 has the responsibility to hire the employees that conduct the actual credit counseling operations. In April of 20XX approximately 40 employees were transferred from CO-3 to ORG. These employees were to conduct the intake services for the credit counseling operations. ORG has indicated that although they were technically transferred, they “remained under the substantive direction and control of CO-5”.¹⁹ Therefore, for the audit period, regardless of what the contracts state, CO-3 hired, trained, and controlled substantially all workers engaged in ORG’s credit counseling operations.

They also provided Job Descriptions²⁰ for “Credit Counselors”²¹. In the summary, it states, “Under general supervision, this position responds to a high volume of inbound inquiry calls from prospective and newly enrolled clients; counsels and educates current and potential clients on debt elimination; and completes a moderate volume of outbound follow-up calls regarding debt counseling and debt management services.”

¹⁹ ORG (POA) letter dated May 7, 20XX.

²⁰ Dated 6-25-XX, 8-30- XX, and 9-15- XX.

²¹ Additionally, ORG provided Job Descriptions used to hire the employees that will train the counselors; however those Job Descriptions were from January of 20XX. While they indicate that High School Diplomas are required, they also indicate that some college is preferred.

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The Primary Accountabilities include:

- a) Receives inbound and makes outbound calls with the goal of educating consumers on debt elimination.
- b) Educates consumers on the benefits and limitations of a debt management program.
- c) Follows procedures and scripts to accurately qualify and enroll consumers into a debt management program.
- d) Assists current and potential clients with setting financial goals for debt elimination.
- e) Ensures that client information is accurately entered into the company's computer system.
- f) Meets or exceeds daily and/or weekly goals as outlined by Supervisor.
- g) Probes to identify any outstanding questions and/or reservations about the debt management program.

Specific Tasks or responsibilities of any specific employee are to be documented in the employee's performance objectives outlined by their immediate supervisor. ORG did not provide samples of these performance objectives.

The job descriptions require the potential employee to have a High School Diploma or equivalent. They require the applicant to clearly read and articulate a written script. They prefer previous experience in "credit counseling, sales, customer service, or call centers" and/or "experience in credit, finance, banking, or industry related experience".

There are only minor immaterial differences between the three versions. These differences do not relate to either education or MOTTO. One item of note is that the last version specifically mentions approval by the Director of Consumer Credit Counseling, Secretary.

In terms of training and experience, the newly hired employees are only required to have a High School Diploma or equivalent and no experience related to educating consumers about their finances. Therefore, the education and training provided by ORG or CO-3 would have to prepare its employees to be able to do this.

Training

After an employee is hired, ORG has testified that they will receive two weeks of classroom instruction plus one additional week of on-the-job training. ORG provided a 28 page manual they used for this training. Because this is the only training required by ORG before they start counseling potential clients, the complete manual is included as Attachment 3.

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The manual does not discuss personal finances or budgeting. It contains a flowchart labeled Operational Work Flow²², which can only be described as a MOTTO flowchart. The manual provides general information only and indicates that CO-3's purpose is to get potential clients on the CO-6 program (a MOTTO).

In our Information Document Request dated 7-3- XX, we provided the above statements to ORG and informed them that we felt, "The manual as provided is so general, it would seem of better use as classroom slides than an actual manual for classroom instruction. It is completely inadequate for its stated purpose." We also asked for additional information about their counselor education and training to allow them to refute these statements. They did not refute the statements made about this training material or provide any additional information to suggest that this initial 2 week training class was more comprehensive than as presented above.

As stated before, the classroom training was followed by one-week of on-the-job training. ORG provided no information on this training to indicate additional subjects were covered during this training. In fact, they provided no information to document what items were covered during this period.

In addition to the initial training employees received, ORG has stated their counselors receive certification training if they are employed for at least 6 months and before they have reached their 1 year anniversary. While the AFCPE Study Guide and ORG have stated that 6 months experience is required before they can take this training, the AFCPE website provides conflicting information and states 2 years experience is required²³.

Additionally, ORG has provided conflicting information as to actually which certification program(s) it used during the audit period. ORG has stated they used the NIFCE certification before they used the AFCPE certification, which they used beginning in 20XX. At a later date, ORG provided copies of actual certificates issued to their employees. While not all certificates were dated, we found some NIFCE certifications dated during the audit period, but we did not find any AFCPE certifications dated during the audit period.

NIFCE

While ORG only provided what they referred to as a lesson plan, containing chapter titles and blank chapter questions, we have obtained the NIFCE materials from outside sources and have reviewed these materials separately, Attachment 4.

²² Page 5 of the manual.

²³ The AFCPE websites, both the current and the one from Feb. 20XX, indicate to become accredited; a person must show proof of two years of counseling experience.

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The NIFCE materials teach counselors that the purpose of credit counseling is to help the callers get out of debt by placing them on a MOTTO. The manual assumes this to be the goal and so the counseling sessions, the communication, and the sales or counseling techniques taught are based on getting them on a MOTTO.

When compared to the Core Analysis Tool, this manual consistently teaches these employees how to perform the counseling sessions, such that each item in the counseling session section would result in potentially non-exempt factors.

AFCPE

Although, ORG has not provided documentation to show this was used during the audit period, we have decided to review this material anyway; see Attachment 5 for our review. This training program is designed more in line for an exempt organization than the NIFCE materials. This training takes a major departure, from the NIFCE materials, in that it does not assume that a MOTTO is the primary option for helping people get out of debt. However, we determined that two of the three items on the CAT are potentially non-exempt factors.

Employee Evaluations and Compensation

ORG provided "feedback" forms²⁴ used to evaluate employees. The feedback form at its most fundamental level evaluates how closely the employees follow the scripts provided. They are also evaluated on their communication techniques and their rapport with callers, their effective use of time, and documenting the calls. Counselors are not evaluated on developing or presenting options to match the particular circumstances of each client. Because of the lack of information provided, we were unable to tell if they are evaluated on how many clients sign up for MOTTO.

ORG also provided in their response the criteria used for raises and ranking of employees within the department. This shows 3 items with equal weight comprising 90% of the evaluation, as follows:

"Attendance – the extent to which an employee is punctual, observes prescribed work break / meal periods and has an acceptable overall attendance record."

"Productivity – Extent to which an employee produces a significant volume of work efficiently in a specific time period. (SPH, MPH, CPH²⁵).” These are all likely to be related to calls and the sales of MOTTO.

²⁴ ORG has provided 9 versions of the feedback forms, dated 6-12- XX to 12-03- XX.

²⁵ This may refer to Sales per Hour, Money Generated per Hour, and Calls per Hour, although this is only an educated guess.

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“Quality – The extent to which an employee’s work is accurate and thorough. (Monitoring, goals, feedback).” The items in quotes would seem to make this be consistent with how well the employees are following the scripts and if they met production goals (MOTTO sales). Furthermore, there are no items that directly or indirectly cover the provision of financial counseling, as that term is used in the CAT.

This last item gives a glimpse of how the feedback forms, previously discussed, may have been used to adjust Counselors’ pay, although it is unclear how much the feedback forms actually affect the “Quality” factor.

Finally, ORG was asked if they had anything to do, or have any input into, how compensation was determined for the employees conducting the credit counseling operations; they indicated they did not.

Compensation of Service Provider

Although ORG did not have any input on specific individual's pay, we must not forget that they did execute contracts with CO-3 providing for compensation paid to its back office service provider, who in turn compensated the individual employees.

While this was discussed earlier, it is applicable here, and deserves repeating in this context. The compensation of the service provider is determined solely by the number of people enrolled on MOTTO. This is true for all Marketing, Processing, Customer Service, and General & Compliance services that were subject to contracts between ORG and CO-3.

In April of 20XX, with the transfer of a limited number of employees, they reduced the fees paid for these services, but the fees were still based on a per MOTTO client per month basis. In addition to these amounts, ORG paid for office space, equipment, telephone systems, and IT support to run its CC and MOTTO operations. CO-3 was never, ever compensated based on education provided to clients. It was simply not part of the compensation calculation.

Other claimed educational activities.

ORG has claimed to have numerous other educational activities. During the audit, we created²⁶ a document, Attachment 6, that fully covers the Educational Aspects of ORG that go beyond the actual credit counseling operations. This document is in the form of an interview of EMP-2, the Manager of Company Affairs and Compliance.

²⁶ This document was created with the cooperation and input of ORG to make this as accurate as possible, as verbally represented by ORG.

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During the audit period, quarterly newsletters were distributed to MOTTO clients²⁷ and they received educational notes and reminders near the end of their monthly MOTTO statements. Starting sometime in 20XX, ORG paid for access to the website to their MOTTO clients. The CO-7 Website, with all of its educational links, was made available to the general public. The links went to informative articles and to the and websites.

Most of the items on Attachment 6 have no direct or indirect relation to the credit counseling operations. Furthermore, besides mailing the materials to or making the materials and websites available to the MOTTO clients, there is no direct correlation to the credit counseling operations. Specifically, ORG counselors are not instructed to discuss any of these items with the clients other than mentioning that they exist. They are not part of any curriculum or regular course of study required of ORG clients. Also, the notes, messages, and newsletters are general in nature, meaning they are the same for all persons, i.e. they are not specific to the circumstances of any of ORG's clients.

Credit Repair / Debt Settlement / Debt Consolidation

Credit repair is a service that claims to do one of two things: some credit repair agencies contact the credit reporting agencies and obtain removal of inaccurate or outdated negative items from credit reports; other agencies claim to be able to remove some or all negative items, regardless of their accuracy.

Debt settlement is a service where an offer for less than the amount due is made to a creditor to satisfy a debt in full. This can be done in a manner that is detrimental or beneficial to the debtor, depending on the ethics used in performing the service.

Debt Consolidation is a service where a loan is provided or arranged for a debtor that will be used to pay of most or all of a debtor's unsecured debt. This will allow the debtor to have only one bill and will hopefully lower the overall payment and interest paid by the debtor over the term of the loan as compared to paying off the individual debts.

We have found no information that ORG is involved in any manner with credit repair, debt settlement or debt consolidation.

(E) Additional Facts Developed During Audit:

This section will present additional facts that help to provide a complete picture of ORG. It will include more detailed financial information, a detailed presentation of the Contracts between ORG and CO-3, followed by some miscellaneous items.

²⁷ These may have been sent to others in their database.

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Financial Information

Income

ORG's sources of revenue are contributions, Credit Counseling Fees, interest income and miscellaneous revenue. Their income averages 99.4% from credit counseling over the past 5 years, as shown in the chart below, and 99.3% over the two years of the audit.

The credit counseling line item above includes both fair share payments and fees charged to credit counseling clients. ORG has separately reported these amounts only in the last three years show above. For those last three years, fair share payments have been reported at 27.3% of total credit counseling fees. Since these figures were earned by ORG's service provider, we did not access their financial records to confirm these figures.

The term "fair share" refers to a payment made by the credit card companies who are receiving payments from their debtors via the MOTTO set up from ORG's credit counseling activities. Typically, credit card companies pay a fair share, which is a stated percentage of debt, to credit counseling organizations that set up MOTTO; the amount paid is determined by each creditor in advance. Credit card companies generally will only make "fair share" payments to organizations recognized as exempt under section 501(c)(3) of the Internal Revenue Code. Instead of paying these funds to a credit counseling agency, a credit card companies may pay a percentage to for-profit collectors or they may sell the debt out-right for a small percentage of the debt owed.

The fees charged to credit counseling clients are amounts paid for the creation of MOTTO, monthly service fees, and in this case funds handling fees.

The other income came mostly in 20XX from the sale of a house and motor home owned by ORG and in 20XX from interest income. These are not significant enough to affect this discussion.

Finally, ORG has stated the contributions they did receive were not related to their credit counseling operations. Instead, these contributions were received for ORG's company work; work that has been on-going since they were created in the 19XX's.

Expenses

Attachment 7 is a spreadsheet showing all amounts reported as expenses, including the amounts from Lines 22 to line 43 of the return and the "other" expenses ORG listed on attachments to their Form 990.

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The following basic information was taken from Forms 990 as filed by ORG for the years ending December 31, 20XX, 20XX, and 20XX.

This is an oversimplified table of expenses as ORG has reported these items on its return. The items comprising the credit counseling expenses are Marketing, Set-up Fees, Processing Fees, Software Fees, General and Administrative Fees, Bank Fees, Consulting – Counseling, Recruiting, Training, and Qualify, and Bad Debt Expenses. Most of these fees were paid directly to the CO-3.

In addition to this, some of the other expenses are clearly related directly to the credit counseling operations. For example in 20XX, ORG became responsible for the intake operations and reported \$ million as a wage expense. However, this illustration clearly shows the amount of expenditures related to credit counseling is substantially all of ORG’s expenditures for the three years above.

Some expenses need some additional explanation however, as follows.

Wages

The table above shows compensation, as reported by ORG, for BM-1 and his daughter, BM-7.

Other wages

As briefly mentioned earlier, other wages in 20XX included approximately \$ million that ORG paid for employees working in its credit counseling operations. If the additional Pension Plan contributions, employee benefits, and payroll taxes are included; this results in about \$ million of additional credit counseling expenses.

Other expenses

Likewise, ORG incurred and reported numerous other expenses associated with its credit counseling activities that they have properly included with other amounts reported on the Form 990. These items may be items like telephone, supplies or similar items. Based on the accounting, differentiating these expenses between credit counseling and other ORG activities was not a simple task. Due to materiality, we did not pursue this.

Grants and Contributions

ORG has reported grants on its Form 990 as shown below from 20XX to 20XX. From the total grants below, the largest percentage went to ORG Country and to CO-8, in the percentages also shown below.

YEAR 20XX 20XX 20XX

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Grants and
Allocations
ORG - Country
CO-8
other

The grants to ORG Country are related to a company outreach ORG started in the early 19XX's. As stated above in the background information, ORG helped create and fund two entities, one in 19XX the other in 19XX, to bring motto to the people of Country.

The grants to CO-8 (CO-8) did not start until 20XX. CO-8 was incorporated on 8-6-02. Its President, CEO, and Statutory Agent is BM-9²⁸, the of BM-1, the president of ORG. CO-8 applied for and the Internal Revenue Service recognized its 501(c)(3) status in July of 20XX.

CO-8's mission²⁹ is to provide programs that powerfully and effectively improve the joy and happiness in people's lives through research, publishing, broadcasting, and seminars. Its current work³⁰ includes research and education on life transformation using alpha state training and heart-focused meditation. ORG also provided information that CO-8 provides Hydro Massage therapy.

Amounts paid to the CO-3

Above, we provided information about ORG's expenditures for its credit counseling activities. Not all of these expenditures were paid directly to the CO-3, however substantially all were, as the table below shows. These amounts were taken from ORG's Form 990.

These payments were made pursuant to the contracts ORG had with its CO-3.

Contracts with CO-3

Since ORG contracted for virtually all of the substantive operations of the credit counseling activities³¹, a review of these activities must start with a review of the contracts it has for these services. ORG and CO-3 had contracts which describe the services that were to be provided by CO-3 to ORG on the following dates: November 19XX, January 1, 20XX, May 23, 20XX, July 1, 20XX, and April 11, 20XX. The last three dates are the contracts that were effective at some time during the audit period.

²⁸ It should be emphasized that BM-9 was an active board member of ORG, and signed as a board member on August 2, 20XX; 4 days before CO-8 was incorporated. Her official resignation date is unknown.

²⁹ CO-8institute.org, as viewed on November 28, 20XX.

³⁰ Ibid.

³¹ This was stated in their letter dated August 22, 20XX.

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May 23, 20XX

On this date, ORG and CO-3 signed three separate contracts. These contracts would have been effective from the start of the audit period until the July 1, 20XX contract was effective. Each of these contracts contains an "Attachment A" that lists the services that CO-3 will provide to ORG. These are included as attachment 8.

Per the Marketing Agreement, CO-3 conducts all aspects of the advertising related to obtaining clients to perform credit counseling. CO-3 also performs the intake, counseling, and enrollment activities.

Per the Processing Agreement, CO-3 provides the enrollment, payment, and fulfillment processing of clients in the MOTTO, including any related customer service support functions. CO-3 uses a software package that they have complete design control over, to do this.

Per the Customer Service Agreement, CO-3 provides basic customer service, Call Center Management and maintains all Call Center Technology.

Because of the completeness of these contracts, ORG's responsibilities are extremely limited with respect to the credit counseling operations. Per the Marketing Agreement, ORG must accept the enrollment of each client referred by CO-3, and once accepted they may not be removed from the MOTTO without CO-3's consent.

The Marketing Agreement gives ORG the right to give reasonable approval for any representation or marketing effort, but only if ORG is identified. ORG provided no information to show they had been specifically identified or had been asked for their approval related to this Agreement.

The Marketing Agreement also represents and warrants that ORG is an exempt organization under § 501(c)(3), making this a condition of the contract.

The Processing Agreement and the Customer Service Agreement all contain similar language. The one noted exception is that clients accepted into a MOTTO may not be removed from the MOTTO without ORG's consent. With the language combined from all three contracts, the clients may not be removed from the MOTTO without either CO-3's or ORG's consent.

Pursuant to the above contracts, CO-3 is responsible for providing labor, establishing procedures for employment and compensation of its personnel.

July 1, 20XX

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On this date, ORG and CO-3 signed one agreement that covered substantially the same services as the three May 23, 20XX contracts combined.

Similar to the prior contracts, CO-3 is responsible for providing labor, establishing procedures for employment and compensation of its personnel. However, with this contract, ORG is given the ability to establish reasonable qualifications for counselor employment including, but not limited to, the requirement that they meet CO-11 standards and/or ISO certification requirements.

This contract also provides that ORG was to assign at least one individual, a Director of Credit Counseling (DCC) to serve as the principal point of contact with CO-3 and who would have the right and responsibility for over seeing the performance of the services contracted for. CO-3 was to provide space at their location for the DCC and any other ORG employee the parties agree that should be at the CO-3 location. Further, ORG is to pay reasonable rental value to CO-3 for the space used by any such employee.

Secretary was hired³² as the DCC in 20XX. ORG paid no rent during the operation of this contract, but did start paying rent with the next contract. While the DCC was not hired pursuant to this contract, without providing substantiating documentation, ORG has stated that their in house counsel, Attorney, was a point of contact between ORG and CO-3.

In this contract, ORG, as noted in the Attachments to the contract, has pre-approval authority, which is not to be unreasonably withheld. Additionally, ORG is to approve, and such pre-approval shall not be unreasonably withheld:

- a) All educational materials, presentations, scripts, advertisements, or other materials to be provided to the public or participants on behalf of ORG;
- b) Any substantial and/or material changes to the MOTTO related website; and
- c) All documents, correspondence and other written materials to be submitted on behalf of ORG to any Governmental Body with respect to licensing and/or regulatory issues.

In an IDR dated February 8, 20XX, we asked for all documentation related to this approval authority. ORG responded on March 27, 20XX that they trusted its former board member, relying on CO-3 to act appropriately. They also state that they occasionally attempted to exercise approval authority provided for in the contract but that all such efforts were rebuffed by CO-3.

This contract further states that CO-3 will “discharge its obligations under the Agreement in a manner consistent with the tax exempt purposes of (ORG) and in furtherance of its tax exempt activities”.

³² ORG claims they hired her based on the recommendation of CO-3.

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ORG is to set the enrollment criteria and the fees for MOTTO participants and shall communicate the same to CO-3. ORG is to identify and communicate the criteria to be used to offer free or reduced rate MOTTO participation. We also asked ORG to document that they performed these functions. As before, ORG responded on March 27, 20XX that they trusted its former board member, relying on CO-3 to act appropriately and therefore did not do these things.

Also with this contract, ORG is responsible for compliance expenses, bank fees (from the trust), participant refunds, audit fees, membership fees, and certification fees. The first two may be paid by CO-3 and reimbursed by ORG.

The attachments with this contract are arranged similarly to the ones from the 1-1-XX contract in that it has attachments A to D, instead of one contract for each Attachment as with the contracts dated 5-23-XX. Here, we will discuss the differences between the attachments on this contract and those services as described in the multiple 5-23-XX contracts.

The first things noticed were that the new attachments contained more detail than previous agreements. Also, the heading that was changed to Counseling from the 1-1- XX contract was changed back to Intake on this contract. They also added an educational section (this appeared in the 1-1-XX contract, but not the 5-23- XX contract) to the Marketing Services attachment. This contract was updated based on the 1-1- XX contract, instead of the 5-23- XX contract.

CO-3 is to handle the advertising, per ORG's direction and pre-approval, to guarantee an average of 6000 calls per week are received. CO-3 will handle calls utilizing scripts provided by or approved by ORG and will educate callers per ORG's direction.

ORG indicated they did not provide the above direction and approvals as allowed by the contracts.

Marketing Services

The Educational Services portion of the Marketing Services Attachment indicates CO-3 will, in general, assist ORG in creating educational materials, supplement ORG's educational program to include, a newsletter (minimum 2 page provided to all clients and others requesting it), perform a budget analysis of each caller (mailing it to callers who provide a mailing address along with an educational flyer), supplement educational materials on the website (at least 1 article per quarter), to create educational messages for when clients are on hold, provide callers with access to ORG's free education materials and events, and utilize community assistance organization referral lists.

Processing Services

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They removed the service stated as "Complete designing control over entire software package" from the Software Suite Services. The Customer Service Support function section was replaced with a Creditor Relations Management section. This is to create and maintain relationships with the creditors, attend industry conferences and maintain an industry presence, and to keep current on significant creditor policies. This appears to be an expansion of "Creditor Interface" services that was removed from the Customer Service Services attachment on the new contract.

Customer Service Services

The Customer Service Support function section from the processing services attachment from the prior contract was moved to this attachment without significant changes.

General and Compliance Services

This component was apparently not present, or not contracted for from 5-23- XX to the effective date of this contract. The services included in this area include: assisting in obtaining licenses, permits, bonding, and to provide various specific financial statements and information for ORG's MOTTO services.

April 11, 20XX

On this date, ORG and CO-3 created an Amendment to the July 1, 20XX Service Agreement and 5 other Agreements for additional services.

The Amendment makes ORG responsible for the duties CO-3 previously did with respect to the intake of clients. This includes items such as the budget analysis and providing callers with information about access to ORG's free credit education materials and events, as well as ancillary duties such as the hold messages callers hear during the intake process. Due to CO-3 reduced services, the marketing fee was reduced from \$ to \$ per month per Paying Participant, but the other contracts require ORG to pay \$ per month to CO-3 in addition to the "per client" charges.

The Agreement for Extra Services was entered into so CO-3 could provide staffing, coaching, quality, and training services, in order to enable ORG to perform the duties they would be required to perform as a result of the amendment. This was at a cost of \$ per month.

The Equipment Lease Agreement was required to lease the equipment used in the intake operations. This was at a cost of \$ per month. The Telephone Services Agreement was for the use of up to 120 ports and approximately 930 toll-free numbers and related services. This was at a cost of \$ per month.

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The Sublease Agreement was for 9781 Sq. Ft. of space in the CO-3 occupied building. This was at a cost of \$ per month. The IT Services Support Service Level Agreement is for various IT services at the CO-3 occupied building. This was at a cost of \$ per month.

Contract Service Fees

The contracts ORG entered into with CO-3 for services naturally produced service fees to CO-3. These fees changed over time, as Attachment 9 shows.

For the three May 23, 20XX contracts, the fees earned are based on a dollar amount per Active Client. An "Active Client" shall mean any person who has agreed to participate in a MOTTO with (ORG) and who has been placed with (CO-3) by (ORG) for processing services under this agreement.

For the July 1, 20XX contract the fees earned are based on a dollar amount per "Active Participant" or "Paying Participant". "Active Participant" shall mean any person responding to the marketing efforts of CO-3 conducted on behalf of ORG who: 1) has completed a counseling session and has agreed to participate in ORG's MOTTO; 2) has completed an enrollment packet by returning a signed MOTTO agreement agreeing to participate in ORG's MOTTO; 3) has made their first payment to ORG under the MOTTO agreement or has returned an agreement authorizing an automatic withdrawal from their bank account for payments under their MOTTO agreement with ORG; and 4) has not terminated or completed his participation therein in accordance with the ORG MOTTO agreement. "Paying Participant" shall mean any Active Participant who makes a payment under their MOTTO agreement with ORG regardless of the payment amount.

In operating through these contracts, ORG charges consumers an initial fee to setup a MOTTO in addition to monthly processing fees. ORG also collects a funds handling fee, which they label as voluntary. Like almost all credit counseling agencies, ORG receives fairshare payments from many of the creditors receiving payments from ORG through this process.

ORG'S Application for Exemption:

ORG's exempt status was recognized in June of 19XX. ORG had no ambitions to be involved with credit counseling at that time, and therefore, this was not mentioned in its application.

While ORG started its credit counseling activities in 19XX, they did not report the income from these operations until 20XX. The Form 990 asks if the organization engaged in any activity not previously reported to the IRS. We have no record to show that ORG ever checked this item 'yes' or provided the required detailed description of the credit counseling activities.

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Group Affiliations

CO-9

ORG is a member of the CO-9 (CO-9). The CO-9's overall mission is to promote the highest level of ethical conduct between businesses and the public through voluntary self-regulation, business and consumer education, and service excellence. Any organization can pay to be a member and can continue to be a member if they meet CO-9 minimum requirements.

These minimum requirements include 12 months of satisfactory operation, supplying required corporate information, having required licenses, appropriately responding to complaints and having a satisfactory complaint record, abiding by CO-9 decisions in arbitration, adherence to various CO-9 standards, etc. The CO-9 does not monitor or require that ORG, or any other organization, be educational.

ISO

ORG is an ISO 9001 certified organization.

From the ISO website, "ISO (International Organization for Standardization³³) is the world's largest developer of standards... ISO standards contribute to making the development, manufacturing and supply of products and services more efficient, safer and cleaner"

"ISO 9001:20XX specifies requirements for a quality management system where an organization

1. needs to demonstrate its ability to consistently provide product that meets customer and applicable regulatory requirements, and
2. aims to enhance customer satisfaction through the effective application of the system, including processes for continual improvement of the system and the assurance of conformity to customer and applicable regulatory requirements."³⁴

The ISO certification results in a system that consistently handles the provision of services to a customer base, in a manner that meets applicable regulatory requirements. A key concept is customer service and constantly improving customer satisfaction. The ISO standards are generic, such that the actual service or product is irrelevant in becoming or remaining ISO certified.

It is common practice in the credit counseling industry for an organization to be ISO 9001 certified as many creditors require a business to be ISO 9001 certified, or be certified by a similar agency. An ISO

³³ ISO is the English Translated abbreviation. The abbreviation is not IOS.

³⁴ From ISO website, 10-10-05.

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certification has nothing to do with the content of any service; it is only concerned with the process and procedures of providing a service.

CO-10

ORG is a member of the CO-10 (CO-10), which represents the newer commercial-type credit counseling organizations.

“CO-10 is the credit counseling and debt management industry’s largest trade association with nearly 150 members nationwide. It is an industry education and advocacy organization whose mission is to promote and ensure the continued operation and viability of credit counseling and debt management organizations. CO-10 provides its members and the consumer public with information about the credit and debt counseling industry. CO-10 members are debt management organizations, consumer counselors, personal finance educators, credit and debt information publishers, debt pooling organizations, debt negotiators, debt adjusters, credit counselors, consumer lawyers and many others.

CO-10 provides timely and important information to members through our newsletter and other publications that tell about the latest developments in sales & marketing, training, economic trends, technology, accounting, legislation, and the topics that impact your organization and its daily operations.

The information that you receive from CO-10 is the most up to date information available to help boost your bottom line. Our newsletter gives you important and timely information on what's happening with creditors, the IRS treatment of non-profits, FTC, small business regulation, credit reporting, the states, consumer credit protection laws and debt collection practices.

"Your Fair Share", the CO-10 newsletter, gives you information about the most important marketing and advertising techniques, growing your organization, customer benefits, changes and advancements in technology, and strategic analyses of the issues that are most important to your bottom line.”³⁵

CO-10 does not monitor, audit, or otherwise ensure that their members conduct educational activities.

CO-11

ORG was a member of the CO-11 (CO-11) during the period under audit. CO-11 is a national membership organization, established to promote quality and consistent delivery of credit counseling

³⁵ From the CO-10 website, 9-26- XX.

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services.

The following information was taken from their website:

Vision

The CO-11 represents the common interests of member agencies to ensure that all who seek help with their debt problems receive the highest quality of assistance.

Mission

The CO-11 is a member-supported national association representing non-profit credit counseling companies that provide consumer credit counseling, debt management, and financial education services.

THE CO-11 PROVIDES HIGH-VALUE SERVICES DESIGNED TO ESTABLISH EQUILIBRIUM BETWEEN CONSUMERS, CREDITORS, AND MEMBER AGENCIES FOR THE SUCCESSFUL REHABILITATION OF DEBT-CLASTNAMEENGED FAMILIES AND INDIVIDUALS.

The CO-11 meets this mission by:

- o Setting industry standards and providing consumer protection guidelines for its members. It also provides compliance oversight and concentrates its efforts in the best interests of its members and the consumers they serve.
- o Representing its members before state and federal legislative bodies, supporting consumer issues and industry initiatives with the media, championing consumer financial education, and campaigning for equity and fair interaction between the nation's creditors and the credit counseling industry.
- o Providing informed leadership, advocacy, and value-added services to its members by collecting data on member needs, measuring member satisfaction, and continuously striving to improve association effectiveness.

CO-11 does not monitor, audit, or otherwise ensure that their members conduct educational activities.

CO-11 also represents the newer, commercial type credit counseling agencies.

PRIMARY ISSUES:

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Should ORG's tax exempt status under 501(c)(3) of the Code be revoked, because:

Issue 1 – Its primary activities do not accomplish an exempt purpose?

Issue 2 - More than an insubstantial part of ORG's activities are in furtherance of a non-exempt purpose?

Issue 3 – ORG was operated for the purpose of serving private rather than public interests?

Issue 4 – ORG has allowed private inurement to exist in conducting its operations?

LAW:

Section 501(a) of the Internal Revenue Code 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 organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 6033(a)(1) of the Code provides, except as provided in IRC §6033(a)(2), every organization exempt from tax under Section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Section 1.501(c)(3)-1(a)(1) of the Regulations 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.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will

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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. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized and operated exclusively for one or more of the purposes unless it serves a public rather than a private interest. To do this, an organization must establish "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."

Section 1.501(c)(3)-1(d)(2) of the Regulations defines the term charitable to include, in part, relief of the poor and distressed.

Section 1.501(c)(3)-1(d)(3) of the Regulations defines the term educational to include (a) instruction or training of the individual for the purpose of improving or developing his/her capabilities or (b) instruction of the public on subjects useful to the individual and beneficial to the community.

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

Section 1.6001-1(e) of the Regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

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

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

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

Rev. Rul. 65-299, 1965-2 C.B. 165, granted exemption to a 501(c)(4) organization whose purpose was to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been counseling people in financial difficulties to "analyze the specific problems involved and counsel on the payment of their debts." The organization also advised applicants on proration and payment of debts, negotiated with creditors and set up debt repayment plans. It did not restrict its services to the needy. It made no charge for the counseling services, indicating they were separate from the debt repayment arrangements. It made "a nominal charge" for monthly prorating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions. The reference to "lending agencies" suggests that what are now called fair share payments were involved.

Rev. Rul. 70-186, 1970-1 C.B. 128, which relates to an organization exempt under section 501(c)(3) of the Code organized and operated to maintain and improve a lake as a public recreational facility. In that ruling, the private benefits derived by lake front property owners were found not to lessen the primary public benefits flowing from the organization's operations. This case is distinguishable from a situation where an organization uses its funds primarily to foster private interests and the benefit, if any, to the general public is only incidental.

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (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

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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). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were “an integral part” of the agencies’ counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies’ principal functions, as only approximately 12 percent of the counselors’ time was applied to debt management programs and the charge for the service was “nominal.” The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. 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.

The organizations included in the above decision waived the monthly fees when the payments 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. 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.

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, 19XX-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.

The court held in B.S.W. Group, Incorporated v. Commissioner of Internal Revenue, 70 T.C. 352 that “It is with some reluctance that we conclude that petitioner is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial. Petitioner’s officers, at least for the present time, serve without compensation, and there is no indication in the record that their personal motives are different from the stated purposes of petitioner. Furthermore, we are troubled by petitioner’s assertion, on brief, that commercial consulting firms have not, in fact, shown any inclination to enter this particular field of consulting. Nonetheless, limiting our consideration to the materials in the administrative record as we must, we are unable to find

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that petitioner's primary purpose is educational, scientific, or charitable, rather than the conduct of an ordinary commercial consulting enterprise in competition with other commercial firms.”

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

In *St. Louis Science Fiction Limited v. Commissioner*, T.C. Memo 1985-162, April 2, 1985, the Court reviewed the annual convention of a science fiction organization. It held that while the conventions may have provided some educational benefit to some of the individuals involved, that social and recreational activities and private benefit predominated.

In *Church of Gospel Company, Inc. v. United States*, 640 F. Supp. 96, 1986 U.S. Dist., due to the taxpayer's failure to keep adequate records, the court held that the taxpayer failed to sustain its burden to show that it was qualified for federal tax exemption as a corporation organized and operated exclusively for religious and charitable purposes, as required under IRC §501(c)(3), and that it was further qualified to receive deductible charitable contributions under IRC §170(c)(2). The court found that the inadequate records failed to show that the taxpayer's operations did not inure to the private benefit of its officers, as provided under IRC §6001. The court found that as a prerequisite to an IRC §6033 filing exemption, it was necessary for the taxpayer to show it qualified as an IRC §501(c)(3) organization, which it could not.

In *CO-9 of XYZ D.C., Inc. v. United States*, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Also, the existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. The Court found that the trade association had an “underlying commercial motive” that distinguished its educational program from that carried out by a university.

Similarly, 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 analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purposes that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

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

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C., 20XX), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

The Credit Repair Organizations Act (CROA), Pub. L. No. 104-208, § 2451, 110 Stat. 3009-455 (Sept. 30, 19XX), 15 U.S.C. § 1679 *et seq.*, effective April 1, 19XX imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. § 1679b. Significantly, section 501(c)(3) organizations are excluded from regulation under the CROA.

The CROA defines a credit repair organization as:

- (A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—
 - (i) improving any consumer's credit record, credit history, or credit rating, or
 - (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

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15 U.S.C. § 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re National Credit Management Group, LLC, 21 F. Supp. 2d 424, 458 (N.D.N.J. 19XX).

Because 501(c)(3) organizations are exempt from regulation under the CROA, organizations that are involved in credit repair have added incentives to be recognized as section 501(c)(3) organizations even if they do not intend to operate primarily for exempt purposes.

In FTC v. Gill, 265 F.3d 944 (9th Cir. 20XX), aff'g 183 F. Supp. 2d 1171 (20XX), the appellate court inferred that a credit repair organization that first promised a "free consultation," but charged fees in advance of the full performance of services was being operated as a charity primarily for purposes of evading regulation under the CROA.

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission. 16 C.F.R. § 310.4(b)(1)(iii)(B), effective October 1, 20XX; 47 C.F.R. § 64.1200(c)(2).

In Credit Counseling Centers v. S. Portland, 814 A.2d 458 (S. C. Me. 20XX), the Supreme Court of Maine denied state tax exemption to a credit counseling agency that provided significant benefits to creditors. Credit card companies commonly make payments to credit counseling agencies of a portion of the funds they receive from clients of the agencies. These payments are known as "fair share" payments and are a source of substantial funding for credit counseling agencies. In this case, the credit counseling agency received 60 percent of its income from "fair share" payments from credit card companies, at the rate of 8.5% to 9% of debt payments.

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).

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

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inurement and private benefit.) Also, its activities were directed at providing opportunities for recreation, not education.

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. 19XX). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

The Tax Court holds in People of God Community, v. Commissioner of Internal Revenue, 75 T.C. 127, that "Part of petitioner's net earnings inure to the benefit of private shareholders or individuals. Accordingly, petitioner is not exempt as an organization described in sec. 501(c)(3), I.R.C. 1954."

"The statute specifically denies tax exemption where a portion of net earnings is paid to private shareholders or individuals. We hold here that paying over a portion of gross earnings to those vested with the control of a charitable organization constitutes private inurement as well. All in all, taking a slice off the top should be no less prohibited than a slice out of net."

"In other words, section 501(c)(3) denies exempt status to an organization whose founders or controlling members have a personal stake in that organization's receipts. Founding Church of Scientology v. United States, supra. Such is the case here, where petitioner's ministers, and Donhowe in particular, completely control its affairs. Petitioner therefore fails to qualify for exemption under section 501(c)(3)."

GOVERNMENT POSITION:

Audit Observation and Limitations

Before we discuss and analyze ORG operations, we first need to provide some clarification about what was available to be reviewed. As in most audits, we are not able to go back in time and actually observe an organization conduct the actual activities that they were conducting during the audit period. We must rely on documented evidence to show how they conducted their activities during the period of an audit. We also will look at their current activities and try to determine how the prior activities would have been in comparison. This is the historical approach to examinations. This case is no different to other audits in that respect.

However, there are dramatic differences that affected our ability to analyze the operations of ORG for the audit period. First, ORG contracted out its entire credit counseling operation for the years of the audit. Additionally, ORG did not provide oversight of these credit counseling operations, because they

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relied upon the experience and good faith of CO-3³⁶. Therefore, the documentation they had was almost non-existent. Almost everything they provided had to be obtained from the for-profit CO-3.

Next, it is common in this industry to record phone calls, if for nothing else for training or quality purposes. ORG could provide no recorded phone calls for the audit period.

Finally, this industry and ORG have been put on notice for a few years now about problems with this industry. In 20XX, Congress became involved with this industry conducting several hearings in various subcommittees. Several heads of exempt organizations conducting credit counseling operations were called to testify. In October of 20XX, the IRS, FTC, and State Regulators created a joint news release to warn consumers seeking assistance from credit counseling organizations. The first tip provided to consumers in this notice was to "Check that the organization will help you manage your finances better through counseling and education."

In the November 20XX testimony of Commissioner, Commissioner of Internal Revenue before the House Ways and Means Committee, Subcommittee on Oversight Concerning Section 501(c)(3) Credit Counseling Organizations; he informed the industry of increasing and targeted examinations in the industry. He informed the industry that 30 organizations, representing a significant percentage of the combined gross receipts for the entire industry were at some stage of the examination process, and that the current workload was only the beginning of our compliance effort in this area.

While Congress was gathering additional information from additional hearings, the IRS created and released a Chief Counsel Memorandum in July of 20XX highlighting abuses in the industry.

In October of 20XX, ORG was the subject of a scathing news article in a local tabloid newspaper. This article reveals the millions in revenues generated by its credit counseling operations. It also reveals the millions paid to the CO-3 and the large increases in payments to BM's Family members and the support of CO-8, as well as other improprieties. ORG was contacted for this story and submitted a written response to the tabloid.

Throughout the audit, ORG has indicated they have had inside counsel advising them on issues dealing with credit counseling and compensation. However, they claim this inside counsel, Attorney, was actually hired by CO-3 and ORG was directed to use her as counsel, making her more loyal to CO-3 than to ORG. Overall, they claim the legal advice they relied on was provided by CO-3. ORG will produce information of their above concerns with their counsel if requested.

³⁶ As CO-3 was not created until ORG got into credit counseling operations and ORG is its only client, the CO-3 experience in the industry and the reasons to place good faith in its operations are unclear.

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With all of this background, ORG should have been taking precautions to document their exempt activities as much as possible. Instead, they continued to put their "Trust" into a family friend and ex-board member, BM-10 to not only perform the credit counseling operations in an exempt manner, but also to maintain proof that it was operating in an exempt manner. Evidence of this "Trust" seems apparent with the duties assigned to CO-3 and to the fact they agreed to pay CO-3 a large percentage of revenue under the contracts.

Not only is it a general requirement for an Exempt Organization to be able to document it is operating in an exempt manner, they had both generally³⁷ and specifically³⁸ been put on notice that an audit was extremely likely. ORG did not act in a prudent manner and failed both to control and to maintain adequate records of its largest activity, credit counseling.

In Church of Gospel Company, due to the taxpayer's failure to keep adequate records, the court held that the taxpayer failed to sustain its burden to show that it was qualified for federal tax exemption. ORG's failure to provide records does not indicate, they had the same problems as Church of Gospel Company. In Church of Gospel Company, the inadequate records dealt with financial records and inurement of earnings. In this case, the inadequate records deal with not being able to substantiate their credit counseling operations to show they were operated for exempt purposes.³⁹

As stated before, ORG has had to obtain documentation of its credit counseling operations almost exclusively from their CO-3. We believe the documentation accurately portrays the operations of the credit counseling operations. Any claim ORG makes that the record is incomplete or does not fully cover the operations is due solely from the lack of documentation maintained by ORG.

Additionally, with the recent history of government involvement in this industry, with the full knowledge by ORG, we had to be cognizant of any attempts to provide the illusion that education was more a part of its credit counseling operations than was actually the case.

Agency Considerations

While ORG agrees that CO-3 operated as its agent, it is nevertheless important that we address the agency/independent contractor issue, specifically.

³⁷ From actions by the government and other regulatory agencies.

³⁸ From the IRS informing the industry of current, ongoing, and future audits of the largest credit counseling Agencies and from being singled out by the local media.

³⁹ ORG relied upon CO-3 to maintain these records consistent with the contracts, and CO-3 failed to maintain these records.

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This is a matter of agency law. "Agency" is defined as the fiduciary relation which results from the manifestation of consent by one person (the principal) to another (the agent) that the agent shall act on the principal's behalf and subject to the principal's control, and consent by the agent so to act.

In the EO area, resolving the question of agency determines whether income received by the purported agent, or the acts of the purported agent, should be attributed to the purported principal. This is so because receipt of funds by an agent constitutes receipt by the principal for federal tax purposes. *Maryland Casualty Co. v. United States*, 251 U.S. 342, 347 (1920).

An agent obtains authority to bind the principal through agreement with the principal (actual authority), or through actions of the principal (apparent authority or ratification). In the current case, ORG has contracted with CO-3 for the provision of services. This contract is an actual manifestation of consent by ORG to CO-3 for CO-3 to render services related to credit counseling operations. By signing this contract, CO-3 has consented to act according to the contract.

While the contract specifically states CO-3 is an independent contractor, this does not preclude status as an agent. A principal has greater control over a servant than over an independent contractor, but an independent contractor may still be considered an agent. See *State Police Ass'n of Massachusetts v. Commissioner*, 125 F.3d 1, 18 (1st Cir. 19XX); *Common Cause v. Commissioner*, 112 T.C. 332 (19XX).

The contracts dated in May of 20XX allow CO-3 to perform services under the name and on behalf of ORG, provided that, in communications with 3rd parties, CO-3 does not represent itself as ORG or as a non-profit or tax-exempt entity. ORG maintains control of CO-3 provider as the services are to be performed in a manner consistent with specifications in the contracts.

The contracts require ORG to "accept the enrollment of each client referred to ORG by (CO-3). Once accepted, such person will be considered (ORG) clients and many not be removed by (ORG) from the MOTTO without (CO-3)'s consent." The contract clearly allows CO-3 to enter into agreements for and bind ORG with respect to MOTTO.

The July 20XX contract specifically states that CO-3 is an agent of ORG with respect to services contracted. It later states CO-3 will perform services as an agent under the name and on behalf of ORG, and also requires ORG to accept the enrollment of clients by CO-3.

The contract, as amended in April of 20XX was created to move the counselors from CO-3 to ORG. However, based on ORG testimony, this was done on paper only. The workers worked at the CO-3 location, it was the same workers, performing the same job, with all the same management in place. This

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move would have been seamless, except their paycheck may have come from a different source. This was a paper change only, and did not affect the actual relationship between ORG and CO-3.

Therefore, going back to the definition of "Agency", CO-3 has a fiduciary relationship to ORG created by the consensual written contract. This contract allows and requires CO-3 to act on behalf of ORG to obtain MOTTO clients and to contractually bind ORG in debt management agreements, subject to the conditions in the contract.

Another excellent indication of this Agency relationship is the actual Debt Management Agreement itself. This is a contract that the CO-3 sends out to callers, whereby they are attempting to secure an agreement between the caller and ORG. A reading of this document shows that they use the term CO-6 such that there is no distinction between ORG and CO-3. Based on the script and this agreement, the vast majority of ORG's clients probably were not aware that the CO-3 was even involved. Obviously, CO-3 is the agent of ORG.

While the agreement starts by clearly identifying ORG as the party to the contract, indicating CO-6 is its dba, the scripts show the counselors state, "Thanks for calling CO-6, this is _____. How may I help you?" Later, in promoting CO-6, they are to state "Let me give you some background on us. (Our emphasis) CO-6 is a ..."

Also, so that the Agreement is completely legal, it specifically states that CO-6 utilizes for-profit service providers to perform some or all of its obligations under this Agreement. The Agreement then indicates that these service providers are its agents; the debtor agreeing this agent may perform services under the agreement. Therefore, ORG represents that CO-3 is its agents to its clients.

Finally, ORG has recognized that CO-3 was acting as its agent because it has reported the income, expenses, and claimed the activity as its own on its Form 990 starting in the year 20XX to the present.

We find that the CO-3 is ORG's agent and that income, expenses, and the credit counseling activities are all attributable to ORG.

Issue 1 – ORG's primary activities do not accomplish an exempt purpose?

To meet the requirements of section 501(c)(3), an organization must be both organized and operated exclusively for charitable and other enumerated purposes. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-1(d)(2), Income Tax Regulations.

ORG provides its services to the general public regardless of income. They have never claimed or provided any documentation to support that they operated for the benefit of the poor, so this will not be

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discussed in any detail. Additionally, the class of people ORG provides services to, debtors, have never been determined to be a charitable class and ORG is not making this claim now. Therefore, they are not operated for the benefit of the poor or any other charitable class. Section 1.501(c) (3)-1(d)(2) of the Regulations.

However, educational organizations are classified as charitable. The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Section 1.501(c)(3)- 1(d)(3). In other words, the two components of education are public education and individual training.

Whether an organization operates exclusively for charitable purposes depends on the application of the operational tests set forth in the income tax regulations. The regulations provide:

An organization will be regarded as "operated exclusively" for [charitable] purposes only if it engages primarily in activities which accomplish one or more [charitable] purposes specified in section 501(c)(3).

In the fact section, we provided evidence that ORG's operations are primarily those related to its credit counseling operations, considering time involved, employee resources, and in terms of both revenue and expenses. Also, ORG has agreed that if those activities are attributed to them, they would agree these were and are its primary activity. While they have not provided any reasoned explanation of why they should not be attributed to it, we have explained why they should be attributed to them; due to the Agency relationship between ORG and CO-3.

As credit counseling is clearly their primary activity, we must look at that activity to determine if it accomplishes an exempt purpose. Therefore, for ORG to be exempt, we must find that its credit counseling operations are educational.

As we have indicated above, ORG is a member of several different organizations, including the CO-9, ISO, CO-10 and CO-11. We have described what each of these organizations' activities and purposes are. For the purposes of this discussion, we simply want to re-emphasis what they do not do. None of the organizations have the authority or responsibility to monitor and ensure that ORG is conducting educational activities. While membership in these organizations may seem to be impressive on some level, the memberships have absolutely nothing to do with whether or not ORG is actually conducting educational activities or operating in an exempt manner, period.

Additionally, while it is commendable that ORG is a member of the CO-9, this simply means they have been able to meet the requirements of the CO-9, specifically in terms of complaints from the public.

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This is certainly more than some credit counseling organizations can claim, and does provide some evidence to separate ORG from the fraudulent and abusive credit counseling organizations. Again, however, this does not make them an educational organization.

To determine if ORG's credit counseling operations are educational, we will look at those operations in detail and analyze how the activity was conducted. We will look at various factors to determine the intent and purpose of these operations.

Referring back to ORG's financial information, their revenue and expenditures are substantially all related to not just the credit counseling operations, but to the MOTTO directly. The MOTTO are the source of the credit counseling income; it does not receive income from educating individuals. Also, the expenditures are related to MOTTO, specifically. Remember, the CO-3 fees are based only on MOTTO, they are not calculated based on any education provided.

MOTTO have been around in this industry for some time. They are referenced in both rulings covering the credit counseling industry, Rev. Rul. 65-299 and 69-441. They were also mentioned in the two main cases dealing with the credit counseling industry, CCCS of Alabama and CCCS of Oklahoma. The simple fact that MOTTO are offered is not the determining factor, but in what context are they offered. This is what we will look at to determine if ORG is operated primarily to accomplish exempt purposes, and we will have to look at numerous factors to make that determination.

Counseling Sessions

In order to determine how the counseling sessions were performed during the audit period, we asked ORG to produce recordings of these phone calls. They did not do this, because these were not maintained by ORG or CO-3. We did not listen to current phone calls, because there was no logical reason to assume they would be substantially similar to the calls occurring during the audit period.⁴⁰

As described in the fact section, ORG was able to document how the CO-3 wanted its employees to handle the phone calls (the scripts) and they provided the data collected and maintained from these calls. ORG also provided printouts of the screens CO-3's employees would see during the calls.

Financial Data Collected

The first item we want to establish is the completeness of the financial information CO-3 obtained during the counseling process. Did they obtain information to the extent necessary to put callers on

⁴⁰ With the IRS publishing the fact that many of the credit counseling agencies being audited were revoked or where revocation was proposed, a credit counseling operation, such as ORG's, making millions of dollars, would be highly motivated to ensure that the sessions we review would be educational.

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MOTTO or did they obtain complete financial information that would enable them to provide an educational counseling session as Section 501(c)(3) requires?

We believe that in order to provide financial counseling that is educational a counselor must obtain a complete financial picture. If this is not done, any advice or education provided may or may not be appropriate. On the other hand, in order to qualify a person for a MOTTO such that creditors will grant concessions, financial information that is not as comprehensive still has to be collected and provided to creditors. Therefore, determining what financial data is collected is important.

The scripts do not go into detail about every single financial item that the employee is required to ask about, instead they state items such as "What is your current financial situation?" and "we first need to take a quick look at some (of your) spending habits...". In the case of the Initial Counseling Session Script, dated 6-15- XX E, it then simply indicates to do a "Basic BA (Budget Analysis)". At this point, the scripts do not detail or substantiate that a full financial picture is obtained.

In fact, the scripts actually indicate that at this point in the script they have not obtained full financial information yet nor done a full budget analysis yet. Regardless, the script has the employee determining if they should continue the interview process by getting creditor information or if they should end the call quickly, sending the caller financial tips in the mail and providing them access to website information.

This is very important; without doing the ORG full budget analysis, the script requires the employee to dismiss the caller in certain circumstances.

In fact, before even the Basic BA was done, this pattern is started by just asking for the type of creditor owed. If only non-concession granting creditors are owed, the MOTTO will not save the caller any money, so the script does not require that the employee collect even basic financial information.

This same pattern or technique is repeated again after creditor information is obtained. In this case, if the concessions are not great enough to save either time or money for the caller, they again end the call quickly by sending them financial tips and offering them website information. Again, the ORG full budget analysis is never done.

This pattern or technique is also repeated, if the amount of the debt is too little or if the interest rates are lower without the MOTTO.

If the caller still "qualifies" and they continue on with the script, the next step is to explain how much the caller will save on the MOTTO. They provide estimates of payments and savings on and off the plan. If the caller wishes to continue with the MOTTO pitch, the employee tells them they should close

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their credit card accounts and attempts to get the non-refundable set-up fee. After collecting this fee and getting the callers SSN, the script finally goes into the ORG Full Budget Analysis⁴¹. This needs to be repeated, the ORG Full Budget analysis is not done until after they have enrolled the caller in a MOTTO.

Putting this in context, the script is set up avoid the ORG Full Budget Analysis if the caller will not qualify or does not want to get on a MOTTO. ORG also attempts to place the caller on a MOTTO and collect the set-up fee before it goes into its Full Budget Analysis.

Furthermore, ORG provided several other scripts used in its operations. They have several scripts used after a debt management agreement has been sent to the callers. Depending on the circumstances, these scripts may be used after the caller should have received the agreement package or after it has been signed and sent back to ORG. In these cases, the employee is required to check the budget analysis to make sure the client qualifies.

Again, we have to put this into context of a counseling session. If during the initial counseling session, the person does not qualify, they would not have been sent a debt management agreement. Therefore, the only way they would not qualify at this point, was if they provided additional financial information with the agreement. So again, this indicates that ORG is attempting to sign up clients without full financial information.

Additionally, the scripts also indicate that it is probable that the callers are sent the debt management agreement out without full financial information provided by the caller and with the full knowledge of ORG that it was not complete.

The other documentation provided by ORG about the amount of financial information obtained from the callers was related to the software they used inputting the financial information provided by the callers. First they provided the blank screens. These did appear to contain blanks for fairly complete financial information. However, this doesn't mean the items were filled out on every call.⁴²

Also, if we go back to the scripts, there is a clear distinction between doing a basic and a full budget analysis. ORG did not provide documentation that different screens were used for these budget analyses, although this would make sense. This may be a matter of information being withheld by CO-3⁴³ that

⁴¹ Later we discuss that ORG has not documented that a complete financial picture is obtained, even in the ORG Full Budget Analysis.

⁴² While ORG claimed that the counselor could not get to the next screen until the current screen was completed, in this case, it simply does not make sense. They have clearly provided data retained from calls that is clearly not complete.

⁴³ This comment is based on CO-3 maintaining records of the credit counseling operations.

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may be damaging to ORG's exempt status. CO-3 would be motivated to restrict information that would damage ORG's exempt status as it would seem to be a breach of contract on CO-3's part.

Being that the blank screen shots did not provide proof that ORG collected full financial information we asked them to provide specific evidence that full financial information was collected during the audit period. They responded to this by stating, "The strongest proof that the budget analysis information was not merely collected to qualify someone for a MOTTO is to show the information collected from the individuals receiving a budget analysis only."⁴⁴

The support they provided was a large number of spreadsheets with data on them; the source and validity of this data is unknown. They indicate that this was taken from the population of 3,786 records getting budget analysis information only. They indicate that they reduced this by the number that had both grocery and gas expenses and then choose every third one. They provided 101 sheets, indicating that 303 or only 8% of those people had provided both grocery and gas expenses (For 20XX, a similar analysis showed 120 sheets, indicating 3600 or 11% had both expenses.)

If this information is valid, ORG is claiming that about 90% of the people they "educate" (with no MOTTO elements) do not regularly buy gas and groceries. We believe it makes more sense to assume that ORG did not collect full financial information from these callers. Further, following the scripts, the employees may have filled in some financial information, but during the process found they would not qualify or would not sign up for some reason. Again, following the script, they would have sent them the blank budget analysis packages. In short, the support they provided to show they asked for full financial information, ultimately leads to the conclusion that they did not do this, and this is conclusion is just from examining how they stated the gathered the information.

We randomly reviewed the data sheets in more detail. They provided varying degrees of information (people would naturally have different financial situations) so the completeness of the information is hard to determine with precision. However, just using common sense, getting back to the question they were trying to respond too, "Did they get a complete financial picture in performing their activities?"; these sheets did not confirm this. Additionally, the information led to more questions such as, why were they calling in the first place (some having large cash flow surpluses) and many having no debt at all. Without some recording any debt at all, stating full financial information was obtained doesn't make any sense. These provided no support to show they collected full financial information.

Additionally in providing the financial information obtained from callers in the numerous spreadsheets they provided, they indicate it was proof that they did not get financial information only to the extent necessary to put someone on a MOTTO. This is not a logical assumption to make. Again, we have to go back to the scripts, which indicate that a basic budget analysis was performed as part of a MOTTO

⁴⁴ These are individuals that at some time during the call requested that a budget analysis be provided and nothing further.

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qualification process. Without additional information, we are unable to conclude that ORG collected the limited information on the data sheets, as discussed above, as part of an educational process. The fact that a MOTTO was not offered to that caller does not mean that an educational process occurred; it likely only means either ORG or the caller decided a MOTTO was not appropriate.

Therefore, based on the scripts provided and the documentation collected and maintained on callers, as provided by ORG, we conclude that ORG does not ask clients to provide detailed information about the type, amount and source of all significant items of income, assets, liabilities (including secured and unsecured debt), and expenses. We conclude that ORG asks clients to provide information on their income, assets, liabilities and expenses only to the extent necessary for the counselor to determine whether they qualify for a MOTTO and they stop collecting data as soon as it is clear that they do not qualify.

Financial Health

Here we used the term Financial Health, for lack of a better term. In looking at this factor, we are trying to determine if counselors interviewed clients about their budget and finances, discussing topics including their employment, education, buying habits, significant expenditures, and any significant past or anticipated changes in their earnings, assets, expenses and liabilities, including the reason or cause for those changes. To clarify, we do not believe this is education itself, but a prerequisite step to allow a counselor to be in a position to provide education.

In order to provide educational financial counseling a counselor must discuss this information with the caller. By this we mean, the counselor must determine the callers background, how they spending and how this spending relates to how much they are actually able to spend and finally if there are any foreseeable factors that will change in the financial situation. It would also have some relation to what the caller's financial IQ already is, indicating the need for more or less education and the areas that they may need educated in.

While ORG claims that during the calls, "counselors often discussed"⁴⁵ items such as employment, education, buying habits, and other topics associated with an "exempt" credit counseling operation, this is only an undocumented claim. Instead, we do not believe it is either often or likely discussed, based on all of the facts and circumstances that have actually been documented.

While they state that "there is no separate documentation available to show where this would have been covered," they claim it is reasonable to assume this given that income and liabilities were discussed. Unfortunately, we must clarify they have only documented that income and some liabilities were listed,

⁴⁵ In a subsequent communication, they changed their comment from "often discussed" to "likely discussed". They are either unsure that it was discussed, or they know they are unable to substantiate this claim.

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as shown by the scripts, there is no indication that they were discussed in any detail as would happen in an educational counseling session. Therefore, we believe it is unreasonable to assume these other topics were discussed as part of an educational counseling session.

ORG points to the June 20XX script, evidencing detailed discussions of the reasons for debt problems and possible referrals. We disagree. As there are multiple June 20XX scripts; for these purposes, we will look at and evaluate the script labeled 06-15- XX E (Attachment 10).

To keep everything in context, we will look at this script from the start. After a greeting and getting a name and address, the next step is to determine if ORG is accepting clients in their location. Apparently, if they do not do MOTTO in that person's state, they are not interested in talking with these people for any extended time on the phones. Following the script, if the client actually states they want education (ORG offered no information on the percentages or numbers of individual that asked for education in this circumstance), they explain they can provide a newsletter and the budget tips sheet to them. On a positive side, they do offer to do a budget analysis for those people using the JetB software. Again however, no documentation has been provided on the numbers or percentages of people that are provided this service.

If an analysis is provided, they are to "return to the point of interruption", and finish talking about internet resources. If the person does not have internet access, they end the call.

Let's look at the purpose of the "timing" of this question. Due to lack of documentation, we must use common sense. A later discussion will show that a primary method ORG attracts its clients is from its commercials and its website. We will show, these people have been enticed with and are thus calling for a MOTTO. In this case, the caller looking for the advertised MOTTO benefits (lower rates, reduced fees, one payment) are told:

"We can offer you a wide range of financial education, however, we are not accepting new clients from your state/Country at this time for our MOTTO. I'd be happy to talk to you about the educational resources we have or we can give you the number you can call for an agency that may offer complete services in your state/Country. Which would you prefer?"

Considering the purpose of their call to ORG, and the option to get in contact with another full service agency, we would assume that of the calls in this situation, a very high percentage would end with the referral to CO-11 following the script. Thus it is reasonable to assume that little or no education is provided⁴⁶.

⁴⁶ We also must not forget that ORG has not documented any education was provided in this circumstance.

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Let's get back to the "timing" issue. This is the very first item asked, name and address! While not unusual, we must look at its purpose. If education was ORG's purpose, their reason for existence, even if they could not place a person in a MOTTO, would they not attempt to educate them? On the other hand, if ORG's purpose was to obtain MOTTO clients, would they not create a systematic method which would allow them to determine at the earliest possible time whether or not the person was a good MOTTO candidate. We believe that is the clear intention of this part of the script and we believe and will show that this continues throughout the script.

Assuming ORG is accepting clients in their state; they then start with explaining their reputation and then ask about the caller's financial circumstances. The counselors are to narrow it down to one of 14 different causes, following a script for each different one. This is where ORG was trying to point out that the script evidenced detailed discussions of the reasons for debt and possible referrals. However, the amount of analysis and discussion it takes to determine someone "thinks" they have problems because of say a divorce vs. a medical issue would appear to be extremely limited. This part of the script is completely different than having an in depth discussion with all the financial facts and discussing the topics at issue here.

In evidencing "referrals", ORG makes a huge leap in their claims that after asking the question "Is there a specific reason that is keeping your bills from getting paid?" that they would be able to make any meaningful appropriate referrals. This claim lacking any documented substantiation is simply not credible, although this is more appropriately discussed later.

There is nowhere in the script that leads the counselor to a discussion, much less a meaningful one, of the items associated with this factor. We believe a simply reading of the script indicates this is another clearly negative factor for ORG's exempt status.

Options and Strategies

In looking at this factor, we are trying to determine if counselors, based on information gathered in the first two factors, develop and present to clients a number of options and strategies for addressing the clients debt problems, including creating and maintaining a budget, establishing debt management payment plans with creditors, negotiating directly with creditors on payment or interest rate relief, and filing for bankruptcy.

First, we must start by saying, we have already determined ORG does not obtain a complete financial background, including information on employment, education, buying habits, and other topics associated with an "exempt" credit counseling operation. This makes it impossible to develop or present options and strategies based on a clients complete financial picture. Be that as it may, ORG still claims it meets this criteria and points to the script as their proof, specifically referencing the June 20XX script.

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To support their claim, ORG provides examples and discusses the items in the script under “Possible call reasons.” We started our discussion of this above. The part of the script under “Possible call reasons:” is near the beginning of the call script and before any financial information is provided. In reality, “options” mentioned are simply part of the script to get to the MOTTO presentation. These items are labeled CC-1 to CC-14.

ORG, as an example specifically mentions the options addressed if the client believes “poor money management or difficulty managing expenses” caused their debt situation. The script requires the counselor to identify appropriate agencies to provide assistance. It is actually stupefying that they actually picked this as an example. This in the simplest form would be why an organization would be exempt in the first place, to teach them better money management skills to allow them to manage their finances better. However, Instead of educating them on proper money management, they are stating that they are trying to find some other agency that will help the person. However, even if they were actually trying to help a caller at this point in the call/script, it would seem next to impossible, since they have not asked any questions about the caller’s finances, credit, spending, or any other situation for that matter.

ORG claims the script addresses stopping creditor calls as an “option”. While they give them 5 sentences of information related to this item, even the script states next “getting the calls to stop doesn’t take away the debt”. From this statement they then take the opportunity to sell their MOTTO, “Another option would be joining a program like ours.”

ORG claims the script addressed repairing credit as an option. Again, they do provide some useful and correct information on the subject. However, this is not an option or strategy for addressing their debt problems. After reading the paragraph of information, they continue on with the sales pitch.

ORG noted that a workout is mentioned as an option more than once in the script. Reviewing the script, it is mentioned if creditors are non-concession granting, where only secured debt is owed, where a caller has negative income, where there was no benefit to the caller from the MOTTO, and where a caller’s interest rates are lower without the MOTTO. Essentially, it mentions the workout only if the callers don’t qualify for a MOTTO or if putting them on the MOTTO will financially harm them⁴⁷. While this may set them apart from other credit counseling organizations that operated in a more predatory manner, this by no means makes them educational.

We need to make this as clear as possible. The counselor didn’t review the callers complete financial information discuss several options, and as we will get to later, cover the advantages and disadvantages

⁴⁷ The script indicates that even if the interest rates are lower without the MOTTO, they will still attempt to qualify the person for a MOTTO, if they are behind on their payments.

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of each, followed by the recommendation that a workout be done. What the script shows is the sales rep quickly identified a caller who was not a MOTTO candidate, after getting only the most basic financial information⁴⁸, and at that point suggests the caller attempt a workout with their creditors.

Also, the script covers the extent of and how they are to discuss the workout as an option. After the 'non-concession granting creditors' are determined, the script states "Instead of enrolling these creditors, I would suggest calling them and attempting what is called a 'workout'. That is when you and your creditors mutually come to a payment agreement." After 'where only secured debt is owed' is determined, the script states "I suggest you contact these creditors immediately and see if you can work something out with them directly." The "option" presentation is similar after each item discussed above.

Again, by reading the presentation provided for what a workout is, it again becomes clear that this is a way to efficiently get to the next possible MOTTO call or candidate. It is not, by any means, a detailed description on how to get the workout, how to deal with the creditors, who to deal with, etc. It is a plan and simple dismissal, in order to quickly get to the next potential MOTTO client.

To be fair, after eliminating callers as potential MOTTO clients, probably providing a caller with vague options or alternatives as discussed above, they do generally offer their budgeting tips, newsletters and access to website information.

Although we are getting away from the "Options" issue, this pattern is repeated over and over in the script. As soon as ORG finds they can't put the person on a MOTTO, they attempt to get rid of the caller efficiently by offering them the budgeting tips or website information. This same pattern is taken throughout the script, if the person will not get on a MOTTO (either in terms of qualifying or in terms of wanting to commit to the MOTTO), they attempt to determine this as quickly as possible and dismiss them with as little effort and time as possible.

While ORG may claim that the script allows debtors to continue on in many places in the script, with ORG knowing a MOTTO is not a possibility, there is also many times this is not the case. Additionally, after a caller is told "you won't qualify for our program", we would question how many decide they should continue with the call for additional information and possible education. Without credible documentation of the number of callers who went on to receive more information in these cases, it seems natural to assume, given all the facts and circumstances, that these numbers would be immaterial.

ORG also claims other "options" are discussed with callers. For example, after ORG determines they have too little debt (to make it financially worthwhile for ORG to put them on a MOTTO); they suggest they pay more to creditors. First, this was done after ORG performed a basic budget analysis; as stated

⁴⁸ In the first two options a workout is recommended before the Basic Budget Analysis. In the other three times this is presented, it is done after the Basic Budget Analysis, but before the Full Budget Analysis.

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before, ORG wants to identify the non-MOTTO clients as soon as possible in the conversation to dismiss them as previously discussed.

Let's take a moment to paint this picture in more detail. Someone calls in for credit counseling⁴⁹, they have only \$ in credit card debt and are having problems making the monthly payments. Their income amount and sources are not relevant here, nor are their spending habits or employment status and most likely little else other than the fact that they only have \$ in debt. With this as the sole criteria, the caller is told simply to try to pay more to their creditors and then ORG offers to send callers general budgeting tips and offering them access to a website. They don't even go into there one sentence description on workouts, just to save a little more time. Again, this is not an "option" presented in an educational manner.

Therefore, our conclusion is ORG counselors did not develop and present to clients a number of options and strategies for addressing the clients debt problems, based on a client's financial situation. Instead, ORG sales reps would generally only present MOTTO as an option, even referring to the MOTTO as "our program". They generally make only the briefest mention of other alternatives for addressing the client's financial problems, such as negotiating directly with creditors, paying more to their creditors, or bankruptcy, and this is done only after it is determined they are not a potential MOTTO client.

Advantages and Disadvantages of Options

In looking at this factor, we are trying to determine if ORG counselors discuss the advantages and disadvantages of various options with clients and make recommendations for which options are best suited to meet the clients' individual needs, goals and circumstances.

Based on the previous discussion on the options presented, we already have determined the option presentation is biased to obtain MOTTO clients or to efficiently dismiss callers with no MOTTO enrollment potential. Clearly, the advantages and disadvantages of each option are not discussed with clients. ORG makes recommendations for options that are best suited to make them money or spend less time with callers who will not make them more money. The only option that ORG recommends and discusses in detail, with the scripts clearly documenting the callers understand an option, is the MOTTO.

Referrals

In looking at this factor, we are trying to determine if ORG counselors provide referrals to other organizations for appropriate support services, such as employment, training, and psychological counseling.

⁴⁹ Based on ORG's advertising, they are probably calling up specifically for a MOTTO.

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At first, ORG claimed that counselors routinely advised all callers to visit the ORG website that contained a wide variety of references to other organizations and other support services. From this, we deduced that ORG does not generally provide referrals to other organizations, but they regularly refer clients to their website, enabling them to self-refer.

Having been informed of our opinion, ORG responded by saying the client's desire for privacy and reluctance to disclose the true root of their problems must be recognized. Unfortunately, while ORG recognizes this as a limitation or a difficulty, they do not take the steps necessary to determine the root of the problems themselves, as a financial counselor should. They then defend not determining the root problems stating, it is "presumptuous of a financial counselor to make assumptions about which referral organization would be most appropriate to treat the true underlying problem." Their point being, they disagree that this is their job, and that they should not be expected to do this.

We do not agree. We believe as a counselor (a person with the ability to educate others on financial issues) should be trained, they should be aware of other potential problems, and they should make referrals when appropriate. In this case, we believe it is more correct to state that it is presumptuous to believe that ORG employees, with their lack of training, education, and experience, can be expected to make appropriate support service referrals. We simply do not think they are capable of meeting this factor.

ORG also claims that giving an extensive list of referrals to a person in need is the best way they have to ensure they receive the appropriate services. Again, we disagree; a trained financial counselor should be making these referrals when necessary.

Therefore, we have determined that ORG counselors generally do not provide referrals to other organizations for appropriate support services.

Counselor Education and Training

Another factor that we believe is important is the education and training of the individual employees providing the counseling. If they are not able to provide financial counseling before they are hired by ORG, naturally ORG would have to train them to do this, before they start to perform in their jobs.

Prior Experience

In reviewing the Job Descriptions provided by ORG for their "Credit Counselors", we found they require the potential employee to have a High School Diploma or equivalent. They require the applicant to be able to clearly read and articulate a written script. Finally, they prefer previous experience in "credit counseling, sales, customer service, or call centers" and/or "experience in credit, finance,

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banking, or industry related experience". This position description is more consistent with a sales or telemarketing position than would commonly be thought of for a "Financial Counselor" position.

The only hard and fast "requirements" to be hired then is a High School education and the ability to read a script. While previous experience is a plus, this experience is not required and not necessarily related to providing financial counseling as that term is meant by the Code. Even with these limited requirements, there is no requirement or even preference that the people ORG hires have any H.S. or other courses in any field related to finances or counseling.

Therefore, we can state that employees working with potential ORG clients do not need education or experience in financial counseling or related fields that would prepare them to be able to provide financial counseling to people with financial problems prior to being hired for ORG's credit counseling operations.

With a complete lack of required education or experience in financial counseling before a person is hired by ORG, their training must be quite extensive for it to train High School graduates to become Financial Counselors. The question that must be answered is, "Does the training that ORG provides and requires its counselors to attend and pass, give them the ability to provide financial counseling to ORG's clients?"

Actual Training

After being hired, the counselors receive training prior to starting to work on the phones. This training is 2 weeks long. This training is followed by a week of on-the-job training. After performing their jobs for a period of time, these employees are then required to become certified.

There is conflicting information about when the employees actually take the certification exam, as proof of start dates and exam dates were not provided for these employees. The study guide states they must have 6 months experience, ORG states sometime between their 6th and 12th month of employment, and the AFCPE website states 2 years experience is required⁵⁰. Whichever is correct, it seems conclusive the information contained in this study course is not required by the employees performing work in ORG's credit counseling operations.

ORG has provided the manual used to train its employees during the first two weeks of classroom training, Attachment 3. After reviewing this manual, we sent the following statement to ORG as part of an Information Document Request, asking for comments and any supporting documentation available.

⁵⁰ The AFCPE websites, both the current and the one from Feb. 20XX, indicate to become accredited; a person must show proof of two years of counseling experience.

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“The manual provided has only 28 pages, none of which discuss personal finance and budgeting. The entire thing could be read in less than an hour. Also interestingly, the flowchart labeled Operational Work Flow, provided on page 5 of the manual, can only be described as a MOTTO flowchart. The entire manual provides general information only, and ultimately shows the intent is to get people on the CO-6 program (a MOTTO). The manual as provided is so general, it would seem of better use as classroom slides than an actual manual for classroom instruction. It is completely inadequate for its stated purpose.”

ORG⁵¹ responded that the manual was from October 20XX, but that it would be substantially similar to the one used during the audit period. They did not expand on our comment that it can be read in less than an hour or indicate how they have been able to fill out 2 weeks of classroom training based on this manual. They did add “Subsequent to this, their skills on the phone and with the materials were actively monitored by the trainers for one additional week.” They also provided feedback forms used during the on-the-job training.

The feedback forms⁵² used during their one week on-the-job training period also appear to be forms that could be used at any time during their employment. ORG did not provide instructions or procedures for filling out the forms and they did not provide examples of forms already filled out. So it is difficult to be too precise with our review.

However, having said that, the feedback form at its most fundamental level evaluates how closely the employees follow the scripts provided. While the points vary with the different versions, we will look at the June of 20XX evaluation for these purposes. They can receive up to 100 points in section one; 50 points deal with items directly on the script and the other 50 deals with communication, time use, and proper note entry after the call is finished. From this total, points are deducted for specific items covered in the scripts, depending on whether the call direction was for materials or for the MOTTO. Finally, in section 3, there are several Major Activities that if done/not done they can lose major points (50 or even all their points).

This is the sum total of ORG’s documentation of the 2 week classroom training and the one week on-the-job training. It is obvious that they did not provide all materials used during this 3 weeks of training. At a minimum, they would have had to have been provided the scripts used, since this is what they did during the last week, and their feedback forms keyed into how closely they followed the scripts.

However, the documentation of this 3 week training period, as provided by ORG, has to stand on its own. ORG has therefore not documented that counselors receive comprehensive training in counseling

⁵¹ The response was actually from CO-3, as this was there training materials.

⁵² ORG provided 9 versions of the feedback forms, dated 6-12- XX to 12-03- XX

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skills, personal finance, budgeting, and credit and debt management in live or interactive training sessions and through detailed written manuals.

This is the only training required in order for these employees to perform their jobs for at least 6 months to a year or more on the job. We specifically told ORG we felt this meant that the employees did not need additional training to perform their jobs. If they did need additional training, it would most likely be required at the start of their employment. They did not respond to this and they did not indicate that the job done before and after the certification process was complete was any different. Therefore, it is clear; the certification training is not related to the job performed by ORG counselors.

We, of course, reviewed the certification programs used to certify these counselors. ORG provided the materials to us, and we have provided our reviews of these materials, so they are part of the administrative record. However, because they are not required by ORG to perform the jobs that they hire these individuals to do, we will only summarize the information here.

ORG has provided information on two different certification programs, NIFCE and AFCPE. While ORG, at one time, claimed they used AFCPE in 20XX going forward, they also provided actual certificates that seem to dispute this. The last dated NIFCE certificate is from March of 20XX and the first dated certificate from AFCPE is from February of 20XX. The AFCPE certificates were good for two years, so a good assumption is that the individuals certified by NIFCE were not re-certified by AFCPE until their prior certificate had expired. Since the cost of certification is something they want to avoid, unless the employee is successful, they also wouldn't want to pay for overlapping certifications.

NIFCE certification

Overall, this provides general training in communications skills, problem solving skills, and the credit and debt management industries. The personal finance and budgeting information is limited to 8 pages of information and is very general. The training also makes the assumption that a MOTTO is part of the solution for every debtor, if they qualify. Therefore, there is some degree of marketing involved in the training. While the manual acknowledges qualifying for and assumes the establishment of MOTTO, the manual contains no such specific training for those purposes.

The training covers lots of theory on why people get into debt and how to get them to recognize their problems and want to get out of debt. However, it does not cover how to develop options and recommendations that address the particular circumstances of each client. As stated before, the manual only spend 8 pages on financial problem solving. While it is general, it does provide useful information about cutting expenses and simply states that they should list all methods to generate more income, it does not go into "options" because the manual assumes that a MOTTO is the best option, if a person qualifies.

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This does not contain training on identifying underlying personal problems (such as illness, loss of employment) that might contribute to financial problems or making appropriate referrals. In one paragraph about gathering facts, the manual does state they should look at attitudes toward work, assess job satisfaction, evaluate personal skills, look at options for career development, and consider health issues. However, mentioning these items in one or two sentences out of 233 pages of text and an additional 130 pages of appendixes hardly seems as if they were "trained" in this regard. In fact, they put more effort to stress that this is financial counseling and not therapy and that they are not to diagnose "patients".

Therefore, the NIFCE training assumes a MOTTO is the primary option to help people get out of debt. It also provides extremely limited training on personal finance, budgeting, and credit and debt management. It also does not train employees how to develop options and recommendations addressing particular circumstances of debtors.

AFCPE

This training program is designed more in line for an exempt organization than the NIFCE materials. This training takes a major departure, from the NIFCE materials, in that it does not assume that a MOTTO is the primary option for helping people get out of debt.

While we found this was comprehensive training, covering counseling skills, personal finance, budgeting, and credit and debt management, we were not provided any evidence this was provided in live or interactive training sessions. On the other hand, clearly, it was not MOTTO training. We believe this can be said to be a positive factor.

While the training mentions options and strategies, it does not train the students on how to develop options and recommendations that address the particular circumstances of the clients. This is a negative factor.

While the training recognizes that underlying problems may exist and that referrals may have to be made, it doesn't train them to identify those underlying problems or equip them to make appropriate referrals; another negative factor.

Therefore in evaluating this certification course, we find that there is one potentially exempt factor and two potentially non-exempt factors.

Other training

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ORG has provided information about additional or continuing education provided to these employees. Again, these materials and our full analysis are in the administrative record. In our review, we found most of the items have no relation to educational counseling or are absolutely not covered by ORG's scripts. The one item that was related, budgeting, was only 3 pages in length, but again was never covered by the counselors as documented by their scripts.

Employee Evaluations

As a reminder, we first covered evaluations above in discussing the 3 week initial training, concluding that the single most important factor evaluated by the feedback forms was how well the employees covered the script.

ORG also provided the criteria used for raises and ranking of employees within the department. This shows 3 items with equal weight comprising 90% of the evaluation, as follows:

"Attendance – the extent to which an employee is punctual, observes prescribed work break / meal periods and has an acceptable overall attendance record."

"Productivity – Extent to which an employee produces a significant volume of work efficiently in a specific time period. (SPH, MPH, CPH⁵³).” These are all likely to be related to calls and the sales of MOTTO.

"Quality – The extent to which an employee's work is accurate and thorough. (Monitoring, goals, feedback)." The items in quotes would seem to make this be consistent with how well the employees are following the scripts and if they met production goals (MOTTO sales). Furthermore, there are no items that directly or indirectly cover the provision of financial counseling, as that term is used in the CAT.

Therefore employees are evaluated and compensated, in part, on how much income they produce from MOTTO. They are not evaluated on how thoroughly and effectively they develop and present options to match the particular circumstances of each client.

Training summary

ORG only requires that its new employees have a high school diploma and the ability to effectively read a script. They have no specific education or experience requirements. The training manual used for ORG's initial training, used to teach the counselors how to perform their jobs, is completely inadequate to train financial counselors. All factors, including job descriptions, evaluations, and training manuals, indicate that the purpose of this initial training is to teach the employees how to use ORG's scripts. We

⁵³ This may refer to Sales per Hour, Money Generated per Hour, and Calls per Hour, although this is only an educated guess.

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believe only the first 3 weeks training should be considered for these purposes, as they start working with callers immediately after that training.

Although we felt the certification process should not be considered, we reviewed the two certification courses provided and found both to also be deficient to train financial counselors. Besides the fact the certification is not needed to perform their jobs, any positive factors present in the certification training were not used to perform their jobs. In the absence of documentation that the specific items covered during the certification process are actually used in ORG operations, we believe the certification process is unrelated to the services provided by ORG. Instead, we believe the process is related to requirements by creditors, normally credit card issuers, that the employees handling phone calls are certified. ORG desires to meet this requirement in order to obtain fairshare payments or other increases in payments from the creditors through ORG operations.

Therefore, ORG's training and education does not give these employees the ability to provide financial counseling, as that term is described in section 501(c)(3) of the code.

Outreach and Advertising

Other factors that should be considered to determine if ORG is primarily conducting exempt activities are their outreach and their advertising. The reason this needs to be considered is to determine whether these are done primarily to bring in potential MOTTO customers or whether they emphasize the educational aspects of the organization. How they portray themselves to the public provides an indication of its true primary purpose. It also creates expectations when potential clients do contact ORG. For this discussion, we need to consider their website, any mass media advertising, and direct mailings made to advertise ORG. We will then look at their sources of clients in general.

In this case, we found no information to show and ORG did not provide any information that they sent out direct mailings.

As part of the contract it has with ORG, CO-3 is responsible for advertising related to the credit counseling operations. ORG did not independently prepare any commercials or other advertising related to the credit counseling activities.

ORG provided 28 commercials used during the audit period. Three of the early ones claimed to be able to put callers on their way to financial freedom in as little as 15 minutes. The first 19 of these were simply MOTTO commercials, never even mentioning anything else. Of the later commercials that did mention free educational materials or budgeting, those too clearly were made to primarily promote CO-6's MOTTO as the primary, if not only, solution to the intended audiences' debt problems. The primary purpose of ORG's advertising is to attract potential MOTTO clients.

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ORG was provided our summary of its commercials during the audit. They had no comment about the commercials, which we take to mean they are in agreement with our conclusion. While they didn't protest our analysis of its commercials, they did re-emphasize two items; the educational spot and the radio programs.

We believe the educational spot they were referring to is the

. We did find that this DVD was generally of an educational nature, with only the minimalist of references to CO-6 or asking people to call CO-6 for a MOTTO. What has not been documented⁵⁴ is that it was aired over 1000 times in nation wide markets. We also do not know how this material was presented and whether it was presented in conjunction with the ORG advertisements covered above, which could certainly change the character of the presentation.

Finally, we are unsure that this even matters at this point in that we have to look at this in relation to their other outreach and advertising and determine which was more prominent. It is our belief that the advertising was aired exponentially more than the 1000 times this video aired, making their commercials the overwhelmingly primary advertising / outreach activity. Remember, CO-3 spent over \$ million on advertising to attract clients during the audit period. Therefore, it appears that ORG agrees that their primary method of attracting new clients was geared towards obtaining MOTTO clients.

We also believe it is important to note that this one DVD, which does appear to be educational, was not used to attract callers to ORG's credit counseling operations. ORG has also not claimed it was related to those operations, much less an integral part of them. Thus, it was not used to attract customers and it was not an integral part of those operations. Therefore, the educational nature of this single activity has no bearing on whether or not the credit counseling operations were educational. It only confirms that this single activity, which was not substantial or material in nature, was an educational activity.

Likewise, we reviewed the radio programs that hosted. While these programs were informative and covered financial issues, they were not directly related to financial counseling, in the sense of educating people with Debt problems on how to get out of debt. While he mentioned ORG and provides the toll free number for its credit counseling operations, its main purpose was NOT an advertisement for their MOTTO program. Again, though, we do not believe this is material in scope⁵⁵, they were not intended to attract customers nor were they an integral part of the credit counseling activities; basically they are immaterial and irrelevant to this discussion.

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⁵⁴ ORG verbally testified to this fact.

⁵⁵ These were 30 minute programs on a Motto with a limited audience.

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Based on verbal representations by ORG, they attract about 7% of their customers⁵⁶ from their website. The question that needs to be determined; "how is ORG attempting to attract these individuals from its website?"

We have established that by viewing the homepage, the MOTTO is the prominent feature of the website. It has two action items on the page, both relate to the MOTTO. The links and banners at the top and the left side are the most prominent links on the webpage; they deal almost exclusively with the MOTTO. Education is dealt with at the bottom of the webpage. While it states education is ORG's primary purpose⁵⁷, almost everything else on the homepage indicates the true purpose is to attract MOTTO clients.

Another very important link on their website is the FAQ's. These show what the website owner wants to make sure the readers understand and/or items they believe the website readers would be most interested in. In this case, the FAQ's are called Commonly Asked Questions. Every single question and answer directly relates back to the MOTTO. This is very persuasive and confirms our analysis of the purpose of the website.

We also briefly want to address educational items that can be found on their website, by following links from the homepage or other pages. We do not believe that the primary purpose of a website can be changed, simply by adding more articles or more links to other educational websites. The educational items must be the primary focus of the website or the website must be an integral part of the counseling activities. In this case they are clearly not.

The website in existence at the time of the audit was clearly promoting the MOTTO and its benefits. It was used to attract potential MOTTO clients. The website makes it clear, confirming the review of ORG's actual credit counseling operations; the MOTTO is the only option promoted by ORG to help individuals get out of debt.

Source of Clients

Another aspect to consider is the results of their outreach and advertising; where does ORG gets its clients from?

In analyzing this, we would look at referrals from employers, unions, churches, other community organizations, and possibly creditors as being a positive aspect, if no payments are made to obtain the lists of names or for referrals or the like.

⁵⁶ We are unclear if this is 7% of their contacts, 7% of their MOTTO clients, or both.

⁵⁷ There was an overall progression to stating education was the primary purpose over the course of the audit period. There was never any indication that their actual operations changed substantially over this same time period.

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While we have not obtained figures establishing exactly where ORG obtained its leads or potential clients or the percentages of each source, we do know of their general sources. As we stated earlier, CO-3 provided testimony that they received about 7% of their leads from their website. We also know that CO-3 spent over \$ million on advertising to attract clients during the audit period. The CO-3 has also purchased leads, although we do not know if CO-3 included this in their \$ million advertising budget, or if additional amounts were spent for leads.

As we have already covered, the website and advertising both primarily promote the MOTTO. Additionally, the IRS looks unfavorably at the purchasing of leads, as this is indicative of a commercial operation. ORG's source's of clients is a negative factor for their exempt status; indicative of their profit motive in pushing the MOTTO and that education is not a focus in attracting clients.

Contracts

Another item that provides confirmation of the above statements is the contracts between ORG and CO-3. In the context of this issue, the July 1, 20XX contract and the April 11, 20XX amendment specifically indicates that CO-3 will conduct the advertising, to guarantee an average of 6,000 calls per week are received. Combined with the fact that CO-3 is only compensated by enrolling callers in MOTTO, this does not provide a favorable perception of ORG's credit counseling operations.

Therefore, in summarizing their advertising and outreach, they primarily attract customers for the purpose of obtaining potential MOTTO clients; education is not the primary focus. Additionally, the way ORG contracted for services ensures that the focus of attracting callers and the actual operations themselves are keyed towards obtaining MOTTO clients. ORG's sources of clients also support this conclusion. Not only do they spend millions to advertise their MOTTO, they purchase leads as a means to contact additional potential MOTTO clients.

Governance

Another factor to be considered, in determining if an organization is primarily conducting exempt activities, is how the organization is governed. Are they more concerned with educating debtors, or are they more interested in making money?

To assist us in making this determination, we will need to decide whether the board is independent and community-based or whether it is a small, related board or a board dominated by creditors or others with financial interests in the organization. This will give an indication as to whether the board is looking after the welfare of the public the organization is supposed to be helping vs. persons with financial interests in the operations of the organization.

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Simply looking at ORG's board structure does not provide a useful indication of ORG's intent as it relates to its credit counseling operations. For this we must look at ORG's and its Board's history and ORG's entry into credit counseling.

Prior to 19XX, ORG was a company with a Christian Motto. Its board was primarily BM-1's family, with one exception, BM-10. The BM's and BM-10 families have been business and personal associates for decades. While we believe their association goes back further, we have information to show that as far back as 19XX the families had business relationships linked to the Motto business. BM-10 was considered a family friend, and became a board member in August of 19XX.

While the details are not well documented, ORG testified that as they were considering entering the credit counseling business, BM-10 told ORG that it could earn \$ per month that they could then use to continue and expand their company. ORG has further testified that they put their full faith and trust into BM-10 in conducting these operations through CO-3.

BM-10 remained as an ORG board member for approximately the first 5 years of these operations. BM-15, a key employee of CO-3, followed BM-10 as a board member for approximately another 2 years.

Prior to the audit period 6 of 7 directors were family members. At the beginning of the audit period, based on Jan. of 20XX Board Minutes, the board was composed of 3 family members, their accountant, and BM-15 from CO-3. By the end of 20XX until the end of the audit period, the board consisted of 2 family members, their accountant, a local clergyman and a local math teacher.

The board minutes we reviewed illustrated that the Board was not involved with the credit counseling operations. While they received updates provided by CO-3 and dealt with contract issues, they were not involved with the actual operations. ORG has testified that they, including the Board, the officers, and ORG's employees, were not involved at all. They approved the contract and then received updates and money.

Therefore, they have a small board, which would generally be considered to be controlled by the family. This is true even at the end of the audit period, because the third and controlling member is ORG's accountant. They do not have a board composed mainly of community members representing the public that its credit counseling operations are supposed to be serving. The fact that the board does not actually "govern" the credit counseling operation compounds this as a negative factor for their exempt status. Therefore, we find that the governance of ORG, in composition and in their (lack of) actions, is a factor highly in favor of ORG not operating primarily to further education within the meaning of 501(c)(3).

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Funding Sources

In analyzing funding sources, we are trying to determine whether the sources of funding compromise the independence of the organization or compromise its focus on education and the needs of the clients. We will also do a generally comparison to how exempt organizations have historically been funded.

Over the period of the examination, ORG's tax returns show that approximately 99% of their income comes from its credit counseling operations. It is substantially all of its reported income. They are certainly dependent on this income; income that comes entirely from its MOTTO operations. This is not a positive factor.

The flip side of having 99% of their funding coming from MOTTO, in fees and fairshare, means they receive very little in the form of contributions. In this case, they receive about 0.3% of their total support from donations. None of these donations are received by ORG to further their credit counseling operations. Furthermore, they do not seek any type of donations for this purpose.

The credit counseling organizations that were found to be exempt, including those in Rev. Rul. 69-441 and 65-299 (and remember this one is a 501(c)(4) not eligible for tax deductible contributions), and in both the CCCS of Alabama and CCCS of Oklahoma, as well as the numerous rulings where individual (non-credit) counseling is provided for free, the organizations were all supported by contributions from the public.

For-profit business enterprises are supported by fees paid by those who receive services. While charitable institutions often do provide services to individuals, the cost is generally subsidized by contributors who do not receive anything in return. In B.S.W. Group, Inc. v. Commissioner, *supra*, the court cited lack of solicitation and sole support from fees as negative factors for exemption. See also, Easter House v. United States, *supra*.

Another way to look at this is in how it actually operated. For all purposes, CO-3 had total control of the credit counseling operations. ORG did not monitor and was not involved enough in its operations to actually control them. So let's look at the funding from both of their individual perspectives.

ORG's perspective

The ORG return for 19XX was reported showing no income from the credit counseling operations (it had 3700 clients by mid 19XX). Including income reported on the schedule A from the previous 4 years, they averaged about \$ per year for 5 years. BM-10 promised them \$ per month or \$ per year if they would allow him to operate ORG's credit counseling operations. All they had to do was sign the contract

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with CO-3 and let them help people get out of debt. Granted, they did loan CO-3 \$ to start these operations, but after that they had little risk for loss.⁵⁸

From ORG's perspective, they wanted to accomplish the following: they wanted to get their investment returned, they thought that helping people get out of debt was a good thing to do, and they believed these operations could help fund their company.

While we have no proof that ORG intended to be part of a commercial debt management operations, their lack of participation in its own operation compromised the focus of the operations on education and ultimately compromised their exempt status.

CO-3 perspective

Since CO-3 provides all services related to ORG's credit counseling operations, from the marketing, intake, processing, and customer service, their perspective also would seem important. 100% of CO-3 income comes from payments it receives from ORG based on the contracts they have together. The contract payments are based solely on enrolling and maintaining MOTTO clients. CO-3's income is in no way determined by the education or lack thereof provided to any callers or the public in general.

Since their income is based solely on MOTTO, they have very little incentive to provide education. Their incentive is limited to their obligation as stated in the contract, but this is restricted to their understanding of how the exempt credit counseling industry has operated. So far, the IRS has found that the larger organizations composing this industry have generally not been operating within the 501(c)(3) framework and have not been educating people as required. Therefore, CO-3 was operating similarly to many of the other larger organizations in the industry.

Therefore, compared to the millions in profit it made, the incentive to provide education based on its contract obligations seems relatively immaterial. After all, why should they lower their profits, by providing more education than the rest of the industry? Therefore, the funding mechanism of CO-3 also compromised the provision of education in ORG's credit counseling operations.

In summary, we believe ORG's funding sources are clearly indicative of a for-profit operation and not those of an exempt organization. The manner in which ORG accepted income from these operations and their lack of oversight and control compromised the provision of education to clients. Finally, through the performance of the contract services and its compensation exclusively being tied to MOTTO, ORG compromised the provision of education in its credit counseling operations simply by contracting for these services. Therefore, in evaluating your funding sources, we believe this is a strong factor showing

⁵⁸ ORG had these funds available from the sale of the Motto in XYZ, and BM-10 was a trusted friend, business associate, and then current board member.

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ORG's primary activity is the selling of MOTTO in a for-profit business venture. It is not consistent with an organization that is providing free counseling or counseling that is educational as its primary activity.

Other Factors

The above factors are specific factor related directly to the credit counseling operations that help to determine if those operations are educational. Sometimes there are additional factors that come into play and we will cover these as appropriate. However, we must be careful in considering other factors.

We have established that ORG's credit counseling operations are its primary activities. It is not enough to have some activities that are exempt, if the primary activity is non-exempt. Therefore, in order for other factors to change the character of its credit counseling operations, they have to be an integral part of those activities. First we will determine if the other activities are an integral part of the credit counseling operations. If we find it is, we will consider it as a factor in determining if the credit counseling operations are exempt.

Other Educational Activities

ORG has provided oral testimony, mostly undocumented, of numerous educational activities; Attachment 6, labeled Contact memo. This was accomplished in an interview and the memo was supplemented as we sent the information back and forth.

The attachment shows the activities as they occurred during the audit period. In 20XX, these activities consisted of Newsletters, the website, access to customer service, and monthly statements with reminders. Additionally, in 20XX, they hired a head to their education department and a person who set-up and conducted seminars where he distributed either _____ or Crown Financial materials. They also made donations totaling \$ to other exempt organizations that provide some form of financial education of the public.

The activities above that were related to the credit counseling operations are the Newsletters, the website, access to customer service, and monthly statements with reminders.

The quarterly newsletters are static informational items sent primarily to the MOTTO clients but also to others in their database. Prior to the Summer 20XX edition, this newsletter contained informational items and was used, in part, to promote ORG's MOTTO. After this date, it stopped promoting the MOTTO. The articles were general financial information items of interest to the general public. They were not modified to meet the needs of specific clients. They were not required reading for participants.

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They were simply sent out regardless of the need, desire, or applicability to their clients. So, while these were distributed by CO-3, they were not an integral part of the counseling activities.

We discussed the website earlier; however, even though the purpose of the website was to promote the MOTTO, it does contain educational materials. In this case, it is available to the general public; no passwords are required, and you do not have to provide identifying information to get to the educational items. However, these materials are similar to the newsletters in that they were not modified to meet the needs of the user, and they are not required reading for participants. While they probably have statistics to show hits on the various pages, this does not indicate that the items were actually read with each hit. Finally, while these may be legitimate informational items, they were not an integral part of the counseling activities.

The provision of customer service⁵⁹ for an operation such as this credit counseling operation is generally set up to maintain the MOTTO clients. This will either be reminder calls for payments, payment tracking, or similar. ORG has not indicated the customer service area performed any educational function, and we found no evidence of this in any manual, script, or even a verbal claim by CO-3. There is simply no proof that this has any relation to the provision of education.

The monthly statements with reminders were explained as being similar to items that are commonly found on any number of monthly billing statements received by creditors, utility companies, etc. While they most likely would have an informational tone, these would be no different than an extremely small newsletter; newsletters that we have determined were not integral to these operations.

While they have stated they hired a head for their education department and a person who set-up and conducted seminars, these clearly are not an integral part of ORG's credit counseling operations. Since ORG claims to have had next to no involvement with these operations, logic tells us there is no direct connection. While what they did may have in fact been educational⁶⁰, because it was not integrally related, it will not change the character of the credit counseling operations.

As for the donations totaling \$ to other exempt organizations, this clearly is not related. It is similar to charitable contributions made by any for-profit entity. It certainly does not make their \$ million dollar MOTTO operation educational.

Summary of Analysis – Issue 1 Do ORG's primary activities accomplish an exempt purpose?

⁵⁹ (24 hour toll free number, which allowed callers to leave a message and get a return phone call) per the attachment.

⁶⁰ We did not feel the need to confirm or refute this.

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We find that it is clear from our audit and review of the available information that ORG does not meet the operational test required by Section 1.501(c)(3)-1(a)(1) of the Regulations.

We determined that substantially all of ORG's revenue and expenditures and employee workforce hours related directly to its credit counseling operation making this their primary activity. We have established that their counselors ask only enough financial information to pre-qualify callers into the MOTTO. The counselors do not discuss budgeting and finances, except to collect this information for MOTTO purposes. They do not discuss employment, education, buying habits, significant future changes in finances, assets, or secured debt in any meaningful manner. The counselors do not develop options or strategies tailored to the needs of clients, and therefore are unable to discuss the advantages or disadvantages of those options. The only option at their disposal to help clients is a MOTTO. The counselors are not trained to and therefore are unable to probe for or recognize other potential causes of debt that should be referred to other appropriate social services or programs that may be needed by clients.

Before they are hired, the counselors are not required to have education or experience in providing financial education. While the counselors are trained on customer service and MOTTO, they are not trained in subjects that would allow them to provide financial education. They are not trained to identify the causes of an individual's debt or other personal problems that may contribute to the situation. Additionally, counselors are not evaluated on how thoroughly and effectively they develop and present options to match the particular circumstances of any client. While the counselors are not compensated based solely on MOTTO, they are compensated based on efficiency, productivity, the ability to read ORG's script, and attendance, generally these are all directly or indirectly related to the sale of MOTTO or the retention of MOTTO clients. Furthermore, the compensation of CO-3, who performs all of the credit counseling operations, is compensated solely on its ability to sell MOTTO and retain MOTTO clients.

ORG's advertising and website primarily focus on its _____ services and the benefits of MOTTO. They primarily promote MOTTO as the sole solution to debt problems (based on prominence and relative amount of time and space devoted). Furthermore, CO-3 purchases leads to attract MOTTO clients.

Our review of ORG's governance shows the board of directors is not an independent community-based board, but a small, related board with a majority of the board being family members or persons with a financial interest in ORG. Furthermore, BM-10, the person who directly and indirectly owns 100% of CO-3, was an ORG board member for 11 years, the last 5 when the CO-3-ORG contracts were in effect. A CO-3 key employee, BM-15, continued on ORG's board for two years after BM-10 resigned.

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In operation the board's primary focus was ORG's company operations. While the board may have thought the CO-3 was helping lots of people get out of debt, they primarily thought of this as a source of funds to continue and expand their other company work. There was no documentation that the board took any active roll to ensure the provision of education as part of its credit counseling operations.

Because of their admitted lack of involvement in ORG's credit counseling operations, due to the amount of trust they had in the CO-3, and due to their trust in the expertise of an attorney they believed to be one of the countries leading experts on credit counseling, the board, albeit unintentionally, failed to exercise its fiduciary responsibility to ensure that they were being operating in a manner consistent with their exempt status under Section 501(c)(3).

ORG's funding sources establish that 99% of their income relates to MOTTO sales and retention of MOTTO clients. ORG has received about 0.3% of its total support in the form of donations. However, these donations are received for their missionary work, not for their credit counseling operations.

Also, ORG's entrance into credit counseling and its compensation arrangement with CO-3 compromised the focus of the credit counseling operations on education.

This fact pattern shows a clear and decisive difference between ORG operations and those organizations that have been determined to be exempt in the past. ORG's primary activities, credit counseling, do not accomplish an exempt purpose.

Issue 2 - More than an insubstantial part of ORG's activities are in furtherance of a non-exempt purpose?

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

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in *CO-9 of XYZ D.C. Inc. vs. United States*, supra, the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if we agreed that you were organized and operated for an exempt purpose, the fact that you also have a substantial non-exempt purpose would be sufficient to deny recognition to you. Specifically, the court in *CO-9* held that if education is conducted for a non-exempt purpose, the organization will not be recognized as exempt. Based on all the facts and

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circumstances we developed during ORG's audit, we conclude your MOTTO operations are so pervasive that it demonstrates that you operate in a commercial manner.

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

No court or IRS ruling has indicated that the sale of MOTTO is a charitable activity. Any activities involving "authentic" credit counseling provided to a genuine charitable class or the provision of credit education to the general public would be purely incidental to your predominant non-exempt purpose of operating and carrying-on an ordinary for-profit business. Since we have previously determined your counseling and MOTTO operations⁶¹ are not educational, we are unable to say that those operations are in furtherance of an exempt purpose. Since these operations have been established to be one of your primary purposes, we cannot conclude that you are operating for charitable purposes.

In addition, your credit counseling operations show none of the public involvement that characterizes organizations serving a public interest. Your activities are carried out by paid employees rather than volunteers.

Your board has consistently had a majority of members that are family members or those with a financial interest in ORG, only two current members seem to be selected from the general public, one a local math teacher and one a local priest. Your board members are unlike those in the organization described in *Rev. Rul 69-441, supra*, in which the organization's Board of Directors is comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

Additionally, with the admitted lack of involvement, supervision, and control over your credit counseling operations, CO-3 was free to operate the credit counseling operations as they saw fit. The only limitation to this seems to be the continued flow of income to ORG for its other company work and the occasional report⁶² provided to the board. This allowed CO-3 to operate in a commercial rather than a charitable manner.

Similar to the organization in Easter House, which operated an adoption agency, we have found that your credit counseling operations were operated for a substantial commercial purpose rather than for the

⁶¹ The activities conducted by CO-3.

⁶² ORG provided no substantive documentation of the actual reports given to its board. These were documented only in their minutes with statements such as, BM-10 gave a report on CO-6.

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exempt purposes of providing educational and charitable services to the portion of the public you serve. Any educational activities that you do conduct are merely provided "incident" to your operations related to MOTTO. The funding for these operations is also similar to that of Easter House. These operations are completely funded by fees related to your MOTTO operations. You seek no funds from federal, state or local sources, nor engage in fund raising programs, and do not solicit contributions for these operations. Also like Easter House, no court has found these services in and of themselves to constitute an exempt purpose.

Similar to Airlie Foundation, we believe you would fail the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which you conduct activities, we believe you are operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. The contract you entered with CO-3 creates a situation that allows them to conduct operations for their commercial gain, as follows:

- They have spent millions to advertise to clients,
- they purchase leads,
- they have an efficient MOTTO qualification process,
- they emphasize and evaluate their employees using statistics on efficiency and productivity,
- they retain property rights for all work products, systems, inventions, trade secrets and other proprietary rights associated with services rendered,
- they are assured payments for the continued providing of services if the contract is terminated, and
- MOTTO sales and servicing is the sole criteria to determine CO-3's compensation.

These, as well as other factors allow us to conclude your credit counseling operations were conducted for a substantial commercial purpose.

We believe your situation is also similar to FTC V. Gill. We believe a substantial purpose of CO-3 in contracting with you for your credit counseling operations in 19XX was to avoid regulation under CROA. We also believe that CO-3 wanted to amend the contract in April of 20XX to help CO-3 avoid regulation by the Telemarketing Sales Rule; specifically the Do Not Call Registry provisions as well as to comply with CO-11 membership rules, which was generally required by the creditors to place clients on a MOTTO.

While we found no documentation to suggest that ORG actually conspired with CO-3 to avoid these regulations, by agreeing to these contracts, ORG created a situation whereby CO-3 could avoid these regulations.

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Based on your fee structure, charging both initial set-up fees and monthly fees, you would be considered as charging an advance fee, a practice forbidden to for-profit organizations under the CROA. Only tax-exempt charitable organizations are permitted under the CROA to charge advance fees.

Because CO-3 performed substantially all aspects of your credit counseling operations, and you contracted with CO-3 to operate a credit counseling operation under your name, they were able to avoid regulation under the CROA.

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission. 16 C.F.R. § 310.4(b)(1)(iii)(B); 47 C.F.R. § 64.1200(c)(2). The Final Rule was published on January 29, 20XX. The Commission indicated it would announce at a future time the date by which full compliance with § 310.4(b)(1)(iii)(B), the “do-not-call” registry provision, will be required. Further, the Commission anticipated that full compliance with the “do-not-call” provision will be required approximately seven months from the date a contract is awarded to create the national registry. In April of 20XX, the Commission published guidance that full compliance with the “do-not-call” registry provision was required starting October 1, 20XX, a little quicker than the FTC had originally anticipated. CO-3 was not able to create a workable solution resulting in the amended contract until April of 20XX.

Because CO-3 would no longer be able to freely cold call individuals, CO-3 created the appearance that ORG employees were doing all of the intake services for the credit counseling operations. CO-3 could, of course, continue to call the clients after they were enrolled, as there would then be an “Established Business Relationship” as defined by the Telemarketing Sales Rule. Additionally, CO-3 implemented these changes to meet CO-11 rules. ORG has stated they allowed these changes because they were under the false impression they would have more control over its credit counseling operations.

However, as ORG admitted, while the employees were theirs on paper, they continued to work at the CO-3 location and they continued to be controlled by CO-3. There were no substantive changes in CO-3 operations and activities as a result of the contract amendment in April of 20XX. For lack of a better term, the amendment was a sham and it is doubtful the operations after April 20XX would meet the FTC or CO-11 requirements any more that they had prior to April 20XX.

CO-3 marketed MOTTO through an aggressive system TV commercials, purchased leads, and cold calls. Any successful sale was serviced entirely by CO-3, an organization that is not controlled by you. Your role was limited to contracting with CO-3, which ensured CO-3 was not subject to either the CROA and the Do Not Call Registry rules due to your recognized status as a Section 501(c)(3) organization.

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The contract ORG entered into with CO-3 was commercial in nature, and not educational. ORG has stated that a consideration in entering the contract was that they would be receiving \$ per month from the operation of the contract. Since ORG did not monitor, regulate, or control these operations, but instead relied on CO-3, they created a situation, possibly unintentionally, where they could not ensure the operations were educational. Since the operations were operated in a non-educational commercial manner and ORG continued to reap the benefits from this contract, we believe this shows ORG entered into the contract primarily for the financial considerations promised; which we believe is a commercial purpose.

Likewise, CO-3 in providing the services pursuant to the contract obviously operated this in a commercial manner. This will be discussed in more detail in our private benefit and/or private inurement discussions.

ORG's growth skyrocketed as a result of its multi-million dollar contract with CO-3. Without its 501(c)(3) status, ORG's entrance into credit counseling and its resulting growth would not have been possible. In the contract with CO-3, ORG had to represent and warrant on a continuing basis that it was a 501(c)(3) organization. ORG had to maintain their exempt status to continue contracting with CO-3. We believe this is also a substantial non-exempt purpose.

Overall, the contracts were entered into for commercial purposes and do not appear to benefit a charitable class; we have already established that an educational purpose was not accomplished. This was simply a for-profit trade or business contract, whereby CO-3 will substantially benefit from ORG's exempt status. The contract the two parties entered allowed CO-3 to act as ORG's agent and allowed CO-3 to make millions in the process; this is again a substantial non-exempt purpose of ORG operations.

Another substantial purpose of ORG, as a result of its credit counseling operations, was to generate funds that could be used to compensate BM-1 and his family members. ORG also gave BM-1 free reign to fund CO-8, an entity founded by his daughter.

The above table shows how the family benefit received increased dramatically just as the income from the credit counseling operations increased dramatically.

For this argument, we are in no way stating that the amounts paid to the BM's Family members are excessive or unreasonable. We are also not stating that grants made to CO-8, a recognized Section 501(c)(3) entity, are inappropriate.

However, the increase in Family benefits and the increase in the non-CO-8 grants and allocations indicate that the family benefits are comparable. This is a significant fact, when ORG has indicated a

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primary consideration in entering the contracts was to obtain extra funds to use in their more traditional company work. Regardless of intent, the facts show family members received benefits significant to, if not comparable to the public through ORG's other company work.

Therefore, we find that another substantial non-exempt purpose it to provide funds for the employment and compensation of BM-1 and his Family members. The employment and hiring of relatives is a substantial non-exempt purpose.

In summary, we conclude that due to its credit counseling operations, ORG is operated for numerous substantial non-exempt purposes, including the following: 1) the operation of a commercial, non-exempt, profit-motivated MOTTO program, 2) CO-3's avoidance of CROA and the Do-Not-Call Registry provisions through contracts ORG entered, 3) the maintenance of your exempt status to ensure your commercial contract with CO-3 remains in effect, 4) your continued contracting for CO-3 services providing millions in profit to CO-3, and 5) your provision of funds to compensate numerous family members.

We believe that each of the above aspects of your activities is a substantial non-exempt purpose, each of which preclude your organization from being regarded as "operated exclusively" for one or more exempt purposes within the meaning of Section 1.501(c)(3)-1(c)(1) of the Regulations.

Issue 3 - ORG was operated for the purpose of serving private rather than public interests?

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. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized and operated exclusively for one or more of the purposes unless it serves a public rather than a private interest. To do this, an organization must establish "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."

Creditors in general

We must consider whether ORG provides substantial benefits to the creditors it collects funds for as part of their MOTTO program. Obviously, one result of the operations of ORG is the payment of large sums of money to creditors. They certainly have a private interest in its operations. Additionally, the individual creditors set policies for the MOTTO clients that ORG must follow. Therefore, they exhibit at

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least some indirect control over portions of ORG operations.

ORG provides substantial private benefit to credit card companies in a manner similar to the organization in Credit Counseling Centers v. S. Portland. Fair share is commonly defined as "that amount the organization receives from the creditors for each payment remitted to them." In the absence of any charitable or meaningful educational activities, which we have established, you are operating as a collection agency for these companies. The "fair share" paid by the credit card companies would undoubtedly result in significant savings over the possible costs of not recovering any of the unpaid debt owed them. Thus, these companies clearly realize substantial financial benefits through your collection activities.

In Rev. Rul. 70-186, private benefits of property owners were found not to lessen the primary public benefits flowing from the organization's operations. The ruling went on to distinguish a situation where an organization uses its funds primarily to foster private interests and the benefit, if any, to the general public is only incidental. We believe ORG is more similar to the second organization in that the private interests are primary, and the benefit to the general public is incidental.

In determining if an organization serves a public rather than a private interest, the private benefit must be considered incidental. To be considered incidental, it must be incidental in both a qualitative and a quantitative sense.

In order to be incidental in a qualitative sense, the benefit must be a necessary concomitant of the activity which benefits the public at large, i.e., the activity can be accomplished only by benefiting certain private individuals. In this case the operation of a true credit counseling organization would require creditors to be benefited, because the education that is provided would hopefully lead to creditors that were paid back. However, not in the sense that the credit counseling organization would always collect the money for them, as ORG does, but in that the consumers would learn how to properly manage their finances and credit. Since ORG's operations center around the enrollment of MOTTO clients they are collecting on debt to a much higher degree than the organizations subject to the Revenue Rulings and court cases that help define exempt credit counseling. Therefore, ORG's collections for creditors go beyond those that would be considered necessary for an exempt credit counseling agency.

To be incidental in a quantitative sense, the private benefit must not be substantial after considering the overall public benefit conferred by the activity. This is a straight comparison of the private benefit (the \$ collected for creditors) with the public benefit conferred by ORG educating consumers (we have shown that ORG has failed to perform its exempt function). Therefore in a quantitative sense, the benefit to creditors was not incidental.

Therefore, the benefits received by creditors fail to be incidental, considering both the qualitative and quantitative senses, and only one of the two tests is actually required.

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CO-3 - BM-10 & EMP-1

In particular, we find your association with CO-3 to be very troubling. CO-3 is 100% owned directly by BM-10 or indirectly through trusts by BM-10. As we have established, BM-10 was an ORG board member from 19XX to 20XX. The first contract you signed with CO-3 for services was in 19XX. After BM-10's resignation from your board, BM-15, a CO-3 key employee became a board member for almost another two years.

Earlier we explained how ORG became involved with credit counseling operations, in part, due to a promise of very large income⁶³ flows into your organization, and in part, due to the trust ORG had in CO-3 conducting these operations appropriately. Admittedly, you did not conduct yourself in a manner to ensure these operations were conducted in an exempt manner. Because of your lack of participation, your role was limited to allowing CO-3 to conduct these operations using your exempt status as a shield, assuring CO-3 was not subject to CROA.

Furthermore, you agreed to let CO-3 amend its contract with you in April of 20XX. We have demonstrated that we believe a primary purpose of this amendment was for the purpose to avoid federal regulations in your credit counseling operations by CO-3. As before this contract, ORG had no involvement in the credit counseling operations.

The various contracts, in some form or another, give CO-3 the full rights and responsibility to conduct your credit counseling operations. By this, we mean that it performs all aspects of your operations from attracting clients, to making sales, to processing, to customer service; in short everything. This did not change, even with the 20XX amendments where ORG took over the intake process on paper. The contract pricing was set so that ORG would continue to receive their less significant portion of the profits while giving you an amount meant to be equivalent to the cost of the workers transferred to ORG.

As fee for these services, ORG historically pays out more than 95% of the money collected from credit counseling to CO-3. For example, in 20XX, ORG took in \$ from credit counseling and paid nearly \$ to CO-3. In 20XX, ORG had \$ in credit-counseling revenue and paid CO-3 more than \$. In 20XX, ORG had \$ in credit-counseling revenue and paid CO-3 more than \$. In 20XX, ORG had \$ in credit-counseling revenue and paid CO-3 more than \$ while paying another \$ for the employees CO-3 controlled and used in its operations.

We believe ORG was used by CO-3 to allow CO-3 to substantially benefit from the operations of ORG's credit counseling operations. From the amounts paid to CO-3, BM-10 and EMP-1 received

⁶³ This term is being used relative to ORG's income at that time.

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massive amounts of compensation, through salaries, royalties, and other withdrawals, either directly or through the BM-10 Family Trust. In 20XX, they received \$ in compensation and in 20XX they received compensation of \$.⁶⁴

As stated before, in determining if an organization serves a public rather than a private interest, the private benefit must be considered incidental. To be considered incidental, it must be incidental in both a qualitative and a quantitative sense.

In order to be incidental in a qualitative sense, the benefit must be a necessary concomitant of the activity which benefits the public at large, i.e., the activity can be accomplished only by benefiting certain private individuals. In this case the operation of a true credit counseling organization would require that expenses be incurred to conduct its activities. However, did payments to CO-3 go beyond those necessary to perform these activities? We believe so, and that the millions earned by BM-10 and EMP-1 illustrate this fact. Additionally, we believe that while executives would generally have to be paid as part of a credit counseling operation, the pay BM-10 and EMP-1 received went beyond what would be required in order to perform these operations. Therefore, the compensation of CO-3 and of CO-3's executives would not be considered incidental for an exempt credit counseling agency.

To be incidental in a quantitative sense, the private benefit must not be substantial after considering the overall public benefit conferred by the activity. This is a straight comparison of the private benefit (95% of gross receipts to CO-3 and roughly \$ in compensation to BM-10 and EMP-1) with the public benefit conferred by ORG educating consumers (we have this was not done). Therefore in a quantitative sense, the benefit to CO-3 and to its executives was not incidental.

Therefore, the benefits received by CO-3 fail to be incidental and the benefits received by BM-10 and EMP-1 fail to be incidental, considering both the qualitative and quantitative senses; only one of the two tests is actually required to fail to fail this test.

BM's Family Benefits

Prior to ORG's involvement with credit counseling, ORG was a small company and BM-1, 5 of his family members, and BM-10 were its board of directors. ORG ran its Christian Motto and conducted other outreaches. The family earned modest incomes in following their callings. Credit counseling changed this considerably.

The salary of BM-1 has gone up by 400%, from \$ in 19XX (near the start of its credit counseling operations) to \$ in 20XX (with its credit counseling operations at or near their peak). His daughter BM-7's pay had also gone up as well, from \$ to \$ during this period.

⁶⁴ Additional information and analysis will be presented in the private inurement section of this report.

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Additionally, BM-1's daughter, BM-9, created CO-8. ORG has testified CO-8 was also attempting to become involved with credit counseling, and that BM-10, had promised to pay CO-8 \$ per month, if it would contract with CO-3 to provide services for those operations.

However, because the IRS would not recognize CO-8's exempt status if it conducted credit counseling as described in its application for exemption, it never entered the credit counseling business. CO-8 was recognized as exempt in July of 20XX. Since its inception, ORG has essentially paid for CO-8's entire operation. In turn, CO-8 paid wages to BM-9 and at least one other member of the BM's lineage. Coincidentally, BM-1's two daughters earn about the same amount; within 10% of each other. Both of their salaries are a result of income coming from ORG's credit counseling operations.

Additionally, ORG purchased an RV costing \$ a month after the ORG board discussed facilitating BM1 and BM-2 slowing down and taking a rest. While ORG claimed the RV was purchased for ORG business, they provided information to show that approximately 92% of its use was for BM-1's personal use.⁶⁵

ORG has stated that CO-3 or BM-10 promised it \$ per month, if it agreed to enter the credit counseling business. This would allow ORG to increase its charitable spending. While ORG's expenditures for its company work did increase, the expenditures that benefited the family were comparable.

BM-1's grandchildren include GC-1, GC-2, and GC-3 and GC-4. We have no information to show the amount of wages, if any, paid to the grandchildren from 19XX to 20XX in order to make comparisons. Finally, the amounts above do not include the \$ RV purchased in 20XX, which was sold in 20XX for \$.

As a matter of clarification, we do want to emphasize that we are in no way indicating that any BM's Family member is paid more than a reasonable amount. With little exception, BM's Family members did not perform duties related to ORG's credit counseling operations. Instead, they were conducting ORG's other company activities for reasonable amounts of pay.

However, in terms of determining if public rather than private interests are served, we must again weigh the benefits the family receives with the benefits received by the general public and we must consider the private benefit in both a qualitative and a quantitative sense.

To be incidental in a qualitative sense, the activity can be accomplished only by benefiting certain private individuals. In this case the operation of a true credit counseling organization would require that

⁶⁵ ORG claims Mr. BM's was getting back to his roots, doing company work in a bus. However, they fail to mention that he also owned an RV dealership in the 1980's, per a *New Times* article written in October of 20XX.

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workers be paid, but not specifically that family members be benefited. This is also true of ORG's other company activities. As ORG became more profitable, more and more benefits were paid to BM's family and many were paid at increasing rates. Therefore, in a qualitative sense, these payments to the family members are not incidental.

To be incidental in a quantitative sense, the private benefit must not be substantial after considering the overall public benefit conferred by the activity. This is a straight comparison of the private benefit, in this case approximately \$ for the two years of the audit, with the public benefit conferred by ORG, which was limited since we have shown that ORG has failed to perform its exempt function, educating consumers. In this case we believe it also makes sense to compare the family benefit of \$ to the expenditures made for charitable purposes of \$, especially when you consider that the BM's Family members had nothing to do with the credit counseling operations and the intent was to use the proceeds to benefit the company. Additionally, we do not believe that ORG has provided enough evidence to show that the increased benefit received by the public from the work performed by BM's Family members made their benefits insubstantial by comparison. Therefore in a quantitative sense, the benefit to the family members is substantial.

In summary – Issue 3 – Private Benefit

In conclusion, we find that when looking at the benefits provided to 1) creditors, 2) CO-3 and or its executives, and 3) the BM's Family; the benefits are substantial in nature. All of these are considered substantial separately, when considered in a qualitative and quantitative sense and compared to the benefit received by the general public through your exempt activities.

Any activities involving "authentic" credit counseling provided to a genuine charitable class or the provision of credit education to the general public, would be purely incidental to the private benefits your organization confers to the above "private shareholders or individuals" having a personal and private interest in the activities of the organization.

Therefore, ORG is not operated exclusively for one or more exempt purposes, because of private benefit pursuant to Section 1.501(c)(3)-1(c)(2) of the Regulations.

Issue 4 - ORG has allowed private inurement to exist in conducting its operations?

CO-3 - BM-10 & EMP-1

We believe that the relationship you have with CO-3 allowed the earnings from your credit counseling operations to inure to the benefit of insiders.

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We have established that BM-10 was legally the 100% owner of CO-4 and a 60% owner of CO-5. The remaining 40% was owned by the BM-10 Family Trust with its earnings flowing through to EMP-1. Therefore, BM-10 controlled CO-3. He also was an ORG board member 7 years prior to the first contract between the two entities and he remained an ORG board member for an additional 4 years. The Board (still the 6 family members) accepted his resignation because of potential conflicts of interest on December 31, 20XX, the day before the second of 5 contracts was signed between the two entities. Further, after he resigned, he continued to be represented through a key CO-3 employee and he attended numerous ORG board meetings.

Based on his status as a board member, his status as a family friend, and later his ability to earn large sums of money for ORG, he had a substantial amount of control over ORG. He had enough control such that he acquired the contract with ORG. Further, he had enough control that he was able to completely control the credit counseling operations with little or no oversight or supervision from ORG. Because of this lack of oversight and supervision, he did control ORG's primary activity.

CO-3 needed to use, and did use, the tax exempt status of ORG in order to conduct the credit counseling operations, to attract customers, to avoid federal regulation, and to obtain various states approval to operate in their states. This would not have been possible without ORG's signing the contracts and it should not have continued if ORG provided the level of oversight and supervision consistent with an operation generating the huge amounts of income that these operations did.

As late as April of 20XX, ORG agreed to amend the contract it had with CO-3. Although, numerous employees were transferred to ORG and to its payroll, and this maneuver was intended to be evidence that ORG controlled the intake process; ORG has admitted that it did not control the employees or the intake process. While ORG has stated this was to meet CO-11 requirements, ORG had to be aware that this was meant to deceive at least CO-11. We believe this amendment allowed CO-3 to deceive CO-11 and other government regulators.

As fee for these services, ORG historically paid out more than 95% of the money collected from credit counseling to CO-3. This was done with the full knowledge of ORG. This information was shown on ORG's Forms 990; signed by BM-1. ORG knew they were getting an extremely small part of the gross revenues.

From the amounts paid to CO-3, BM-10 and EMP-1 received massive amounts of compensation, through salaries, royalties, and other withdrawals, either directly or through the BM-10 Family Trust. In 20XX, they received \$ million in compensation and in 20XX they received compensation of \$ million.⁶⁶

⁶⁶ Additional information and analysis will be presented in the private inurement section of this report.

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In addition to the compensation noted above, BM-10 used the income from CO-3 to finance other investments. "The CO-11 opened for business in May 20XX. Conceived by partners BP-1, BP-2, BP-3 and BM-10, the \$ club was to be a full-service facility for military, law enforcement and private citizens alike."⁶⁷ CO-3 by the end of 20XX had \$ invested in an LLC owning a piece of the CO-12 and it loaned the an additional \$ for the year.

BM-10 was getting rich off of ORG's operations. BM-10 was obviously a business associate, but he was also a family friend to the BM's. BM-10 purchased a \$ million dollar home in Paradise Valley, an affluent neighborhood in Arizona.

There can be no dispute that BM-10 and his business associate EMP-1 received substantial benefit from the ownership of CO-3, an entity that gets substantially all of its income from running ORG's credit counseling operations. It is immaterial whether ORG was aware of this. Inurement is inurement, and we do not have to prove ORG had intimate knowledge of its existence. The fact that ORG allowed this to happen and did not take ordinary business care to stop it, is enough.

We also considered the fact that this was not an arm's length transaction and that ORG did not have a Rebuttable Presumption of Reasonableness in helping us to determine if the earnings of ORG inured to the benefit of CO-3.

We have concluded this was not an arm's length transaction. BM-10 was an ORG board member when the CO-3 / ORG relationship was started. The contract itself was signed by BM-1 and BM-10; who have had both a longtime family friendship and whose families have had business relationships since at least 19XX.

ORG failed to establish a Rebuttable Presumption of Reasonableness, failing all three prongs of this test. The contract was not approved in advance by an ORG authorized body composed entirely of individuals who do not have a conflict of interest with respect to the transaction; ORG did not furnish any appropriate comparable data that they relied on for the purpose of payments made to CO-3 under several of these agreements, including the first contract; and ORG or its authorized body did not adequately document the basis for its determination concurrently with making such determination.

Since we did not audit CO-3, we do not know whether CO-3's general and administrative expenses are excessive. It was difficult to determine this with the information provided by CO-3 as information from a third party. Nonetheless, the compensation received by BM-10 and EMP-1 seemed excessive, this being the main focus of this discussion. It is possible that other expenses were also excessive, which would only make the amount ORG paid to CO-3 more unreasonable.

⁶⁷, Tribune, May 1, 20XX

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As stated before, BM-10 and EMP-1 received massive amounts of compensation for these operations, \$ million in 20XX and \$ million in 20XX. Amounts used for the Gun Club will not be used for this illustration.

Attachment 11 (xxx from the economists report) contains the data on compensation paid to highly compensated individuals of some comparable exempt organizations. It is divided into regional and national organizations. The compensation ranges from \$to \$for the highest paid individuals at the regional level and from \$to \$at the national level. The mean compensation for the four highest paid officers at the regional level is \$and \$at the national level. The median is smaller still, \$and \$respectively. Compared to this, BM-10 received average compensation of \$ million per year and EMP-1 received compensation averaging \$ million per year on the average.

Considering more historical data and looking at this from another perspective, the total remuneration for three years from 20XX to 20XX is \$. This was about 21% of the total revenue for these three years. The comparable regional and national median total compensation as a percentage of revenue is less than 1%, clearly an indication that their salary was excessive.

Looking at this from ORG's standpoint, we believe ORG was under-compensated in all of the agreements with CO-3 given the fact that CO-3 could not engage in the activity without ORG and its section 501(c)(3) status. Since we believe ORG was under-compensated, this also supports our contention that CO-3 was over-compensated.

As evidenced by the above, the compensation received by BM-10 and EMP-1 far exceeds the norm and is clearly unreasonable. By its failure to properly monitor CO-3 and its actions, ORG indirectly facilitated these payments and therefore allowed its earnings to inure to the benefit of CO-3.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized and operated exclusively for one or more of the purposes unless it serves a public rather than a private interest. To do this, an organization must establish "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."

The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity" United Cancer Council v. Commissioner. In other words, section 501(c)(3) denies exempt status to an organization whose founders or controlling members have a personal stake in that organization's receipts. Founding Church of Scientology v. United States,

BM-10 being a 100% owner of CO-3 and being a Director of ORG before, during, and after ORG and CO-3 signed their initial contract makes him an insider for the purposes of the private inurement

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prohibition. Therefore, ORG is not being operated exclusively for one or more exempt purposes because it is allowing its net earnings to inure to insider BM-10 and EMP-1 as a 40% beneficial owner of CO-3.

Taxpayers Position:

ORG has testified that they are in many ways a victim too. This is a result of the trust ORG had in CO-3 and the abuse of this trust by CO-3. CO-3 had complete control of the credit counseling operations, they dictated the contracts, provided ORG with legal advice and/or required ORG to hire specific legal advisors. ORG manifested their trust in CO-3 in its contracts, by requiring CO-3 operate in a manner consistent with ORG's exempt purposes.

Therefore, it is their position that at no time during its operations did they work with CO-3 or in any manner conspire with CO-3 to operate outside the rules of Section 501(c)(3). They feel CO-3 failed their fiduciary duty to operate within the terms of the contract, which again required they operate in an exempt manner. They also believe CO-3 manipulated ORG for its own benefit. They also state that the contracts were basically dictated to them by CO-3, essentially giving them a "take it or leave it" type option in signing the contracts.

They believe their error was limited to omission, not commission. Specifically, they failed to maintain enough control or otherwise monitor CO-3 to ensure it was conducting the credit counseling operations within the framework of Section 501(c)(3).

ORG is also adamant that BM's Family members were not inappropriately compensated or otherwise benefited from its operations. They disagree that the benefits they received were substantial in nature, and therefore that this is not a non-exempt purpose of ORG. They correctly point out that the benefits received by BM's Family members can in no way be compared to the benefits executives of CO-3 received. They also point out that if their intention was to withdraw ORG's earnings for the family members, they would have been enriched similarly to those executives.

Conclusion

We do believe that CO-3 had excessive control over the credit counseling operations. We also can understand how someone who has spent decades in company work would be more trusting that what others may be. However, in order for us to conclude this is exactly what happened, we would need some type of documentation of this and ORG has not documented this other than providing statements to this affect. We acknowledge that given the circumstances it wouldn't really make sense that an entity would document that they were being taken advantage of; it is a catch-22.

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We believe that ORG accepted the CO-3 operations as they were in order to increase ORG's income and to use the additional income to further its company, its faith, and its religion. However, the CO-3 operations were not in accordance with section 501(c)(3) principles and ORG was therefore not operated for exempt purposes.

Based on the examination of your actual activities in light of the applicable law, we find you are not operated for exempt purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations 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 of such section. If an organization fails to meet either the organizational and operational test, it is not exempt. Your organization has failed to meet the operational test since you function for the intake and servicing of MOTTO. This is your primary activity, which is non-charitable. This activity does not accomplish an exempt purpose, namely to provide education and financial counseling. Further, your debt management activities are not an integral part of providing education or financial counseling.

We have also determined you are operated for numerous substantial non-exempt purposes, including allowing CO-3 to operate a commercial for profit business not related to any exempt purpose under the auspices of your exemption, allowing CO-3 to operate to avoid regulation by CROA and the Telemarketing Sales Rule; specifically the Do Not Call Registry provisions under the protection of your exempt status, operating to maintain your contract with CO-3 to ensure the continued flow of income to CO-3 and to you, operating for the benefit of CO-3, and operating for the benefit of the BM's Family. As these are all substantial non-exempt purposes, your organization is precluded from being regarded as "operated exclusively" for one or more exempt purposes within the meaning of Section 1.501(c)(3)-1(c)(1) of the Regulations.

We have also determined you are operated for impermissible private benefits for several private shareholders or individuals having a personal and private interest in the activities of the organization such that ORG is not operated exclusively for one or more exempt purposes, pursuant to Section 1.501(c)(3)-1(c)(2) of the Regulations. These private shareholders or individuals include the creditors you collect and remit funds to, CO-3 and its executives, and the BM's Family. This is true even if the applicable amounts were reasonable.

It has also been determined that you allowed private inurement to exist in conducting ORG's operations through its contract with CO-3. Your earnings inured to the benefit of CO-3.

Therefore, for the reasons stated above, your charitable exempt status should be revoked.

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

We believe that the character of your organization probably changed from being that of a Christian Company to an entity with its primary activity being the non-exempt debt management operation starting with your 19XX year. In this year, credit counseling income was approximately 87% of your income. However, we have not audited this year and as you know, there are other factors we would need to consider to determine if credit counseling was your primary activity.

However, we believe that in 19XX when over 95% of your income comes from credit counseling, it is undeniably reasonable to assume it was primary at that time. Additionally, the majority of the issues discussed in this report would likewise be valid when the level of gross income reached the level it did in 19XX. Therefore, we are recommending this revocation be effective as of the beginning of 19XX.

Form 1120 returns should be filed with Agent Ross for the tax periods ending on December 31, 20XX and 20XX.