

**Internal Revenue Service  
Appeals**

Release Number: 201351028  
Release Date: 12/20/2013  
LEGEND  
ORG- Organization name  
XX - Date Address - address

NAME  
ADDRESS

Date 9/25/13

**Department of the Treasury**

**Address any reply to:**  
Appeals Office  
Royal Palm One, Suite 350  
1000 South Pine Island Road  
Plantation, FL 33324  
**Employer Identification Number:**

**Person to Contact:**

**Contact Telephone Number:**

**Fax Number:**

**UIL: 501.03-30**

**Certified Mail**

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated April 11, 2002 is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 2008.

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

Under IRC § 501(q)(1), an organization with respect to which the provision of credit counseling services is a substantial purpose shall not be exempt from tax unless operated in accordance with requirements set out in section 501(q)(1).  
, Inc. has failed to meet these requirements and is therefore no longer entitled to exempt status.

Contributions to your organization are no longer deductible under IRC §170.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 201 and for all tax years thereafter in accordance with the instructions of the return.

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

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for

rules regarding filing petitions for declaratory judgment. To secure a petition from the United States Tax Court, write to the following address:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 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 contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,



Nan M. Shimizu  
Appeals Team Manager

Internal Revenue Service  
Tax Exempt and Government Entities Division  
Exempt Organizations: Examinations  
1100 Commerce St.  
Dallas, TX 75242

Department of the Treasury

Date: November 28, 2011

Taxpayer Identification Number:  
EIN  
Form:  
990 Return  
Tax Year(s) Ended:  
December 31, 20XX, 20XX & 20XX  
Person to Contact/ID Number:

Name  
Address

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,

Nanette M. Downing  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

ORG

EIN: EIN

Tax Periods Ended: December 31, 20XX, December 31, 20XX & December 31, 20XX

**LEGEND**

ORG - Organization name      XX - Date      EIN - EIN      Address - address  
City - city      State - state      Website - website      President -  
President      POA - POA      DIR - through DIR-7 - 1<sup>st</sup> through 7<sup>th</sup>  
DIRECTORS      CO-1 through CO-11 - 1<sup>st</sup> through 11<sup>th</sup> COMPANIES

**Issues:**

1. Whether ORG (ORG) should have its exempt status revoked because ORG purCO-1d client leads in violation of section 501(q)(1)(F) in the years of 20XX and 20XX.
2. Whether ORG was operated exclusively for one or more exempt purposes as described in Internal Revenue Code section 501 (c)(3)?
3. Whether more than an insubstantial part of ORG activities were in furtherance of non-exempt purposes?

**Facts:**

ORG was incorporated under the laws of the State of State as a non-stock, nonprofit corporation on November 13, 20XX. ORG applied for exemption from federal income tax on November 19, 20XX. In a determination letter from the Internal Revenue Service (hereinafter "IRS") dated April 11, 20XX, ORG was recognized as an organization exempt from federal income tax as described in IRC Section 501 (c)(3). Because ORG was a newly created organization and not operational, the IRS did not make a final determination of its foundation status under IRC section 509(a). ORG was given an advance ruling under IRC section 509(a) as a publicly supported organization and not as a private foundation from November 13, 20XX until December 31, 20XX, when the final determination of public support would be made.

In the ORG Articles of Incorporation the stated purposes of the organization were "to provide nonprofit services for the relief of the poor and distressed by informing the public on personal money management and assisting low-income individuals & families who have financial problems through debt consolidation & credit rehabilitation, exclusively for charitable purposes."

ORG was notified in a letter from the IRS on April 17, 20XX of the proposed examination of its books and records to be conducted on May 21, 20XX of the Form 990 for the year ending December 31, 20XX. That examination was subsequently expanded to include the Form 990 for the period ended December 31, 20XX. At the conclusion of the examination of the 20XX and 20XX tax periods the IRS proposed to revoke the tax exempt status of ORG and the organization was not in agreement. The case file was closed unagreed and sent forward for an Appeals hearing at the request of ORG. Unfortunately the case file never made it to Appeals due to the file being misplaced in transit from City, State to City, State. ORG was contacted by IRS to discuss a resolution of the situation. After several conference calls it was agreed by both IRS and ORG that the examination of the Form 990 for the year ending December 31, 20XX would be conducted by a different IRS Revenue Agent to allow the organization an opportunity to exhibit its tax-exempt purposes and to obtain documentation to show what the operations of ORG were during 20XX.

The initial proposal after the 20XX year examination was concluded was to revoke the organization's exempt status effective January 1, 20XX due to a lack of exempt function activity and a substantial non-exempt purpose. For this tax period a Fast Track Settlement was offered and ORG was in agreement. Due to unavoidable delays the 60-day time frame could not be met

ORG

EIN: EIN

Tax Periods Ended: December 31, 20XX, December 31, 20XX & December 31, 20XX

and it was then determined that we would honor the taxpayer's request to examine the 20XX & 20XX tax years and give them an opportunity to show the IRS that they were in compliance with the required rules and regulations concerning consumer credit counseling agencies. At that point an Information Document Request was issued for the years of 20XX & 20XX. It was also determined that although the organization states that the Form 990 for the year of 20XX was signed and filed in July of 20XX there is no record of the IRS receiving that return.

To date the IRS has a record of the following Forms 990, Return of Organization Exempt from Income Tax being filed.

<u>Tax Year Ended</u>	<u>Filing Date</u>	<u>Due Date</u>
December 31, 20XX	May 15, 20XX	May 15, 20XX
December 31, 20XX	February 13, 20XX	May 15, 20XX
December 31, 20XX	July 29, 20XX	May 15, 20XX
December 31, 20XX	August 12, 20XX	May 15, 20XX
December 31, 20XX	(No Record)	May 15, 20XX
December 31, 20XX	April 18, 20XX	May 15, 20XX

The mailing address of the organization as provided on the Forms 990 is Address, City, State. The physical address of the organization is the same. The returns list the books and records as being in the care of President at the above street address for the organization.

During the years of 20XX - 20XX ORG operated as a consumer credit counseling organization and its activities consisted primarily of enrolling pre-qualified client leads into debt management programs (DMPs) and servicing those DMP accounts. ORG was also servicing already established DMP clients transferred from other Credit Counseling Agencies (CO-3), for the payment of the monthly account maintenance fees. (The term "clients" as used in this report refers to customers who enrolled in DMPs with ORG.)

The terms debt management plans or debt management programs (DMPs) are used interchangeably in the credit counseling industry to refer to plans to provide for repayment of unsecured debt. A repayment proposal is prepared and presented to the client's creditors and, after acceptance, a DMP agreement or contract is signed and the client agrees to make monthly payments to the organization, who in turn takes their service fees and distributes the agreed upon payment to the client's creditors. Generally, most creditors offer reduced interest rates to consumers who pay through a DMP. The client pays an up front enrollment fee and a monthly processing or maintenance fee for the DMP. ORG charged their monthly account maintenance fees based on which state a client lived in.

During the years of 20XX through 20XX the primary source of clients was through contractual agreements with lead generation service companies (vendors) who provided ORG with pre-qualified individuals who were in need of assistance to get out of their unsecured debt situation. As explained by the taxpayer's POA POA, "ORG contracts with a series of lead generation vendors, or what we refer to as 'affiliates.'"

The vendor contract language stated that a/l client agreements were to be made in the name of ORG. During the year of 20XX and continuing into 20XX & 20XX ORG was a party to at least a dozen contracts with different vendor companies. Three of the contracts were for the purpose

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Tax Periods Ended: December 31, 20XX, December 31, 20XX & December 31, 20XX

of obtaining new DMP clients. In these contracts the vendor would refer to ORG pre-qualified clients to be enrolled in DMPs. The vendor charged the client an up-front one time fee and ORG would then pay to the vendor a monthly fee as long as the enrolled client stayed in their DMP. The vendors contracted with ORG did not work exclusively for ORG, but for the clients referred to ORG there were specific criteria that the vendors were to use in screening potential clients, one being clients who had credit card accounts with CO-1 or CO-2. POA, the POA for ORG stated that these two paid big fairshare amounts.

In addition, nine other contracts called for the transfer of existing DMP clients from other CO-3 to ORG for the purpose of ORG administering these established DMPs for a monthly fee and in turn they paid to the transferring CO-3 monthly fees ranging from \$ to \$ per DMP client account serviced. One method of obtaining the client transfers was through solicitation letters sent out by the ORG Marketing Department.

If the client had a financial hardship they could request in writing a waiver of the monthly fees and ORG management would consider those requests. In 20XX less than 1% of the clients paid fees of \$ or less or no monthly fees. It has not been demonstrated that the ORG credit counselors presented any options for the prospective clients other than the DMP, except that on occasion if it was determined that debt settlement rather than a DMP was the best option a referral was made to CO-4 (CO-4), a for profit company owned by President, the CEO of ORG.

In addition to collecting and distributing payments to creditors ORG solicited "fair share" payments from the client creditors. ORG submitted annual applications to the creditors to be able to receive the fair share amounts. The term "fair share" refers to a payment made by the credit card companies who are receiving payments through a DMP arrangement. The credit card companies would typically pay a fair share to the DMP servicing company. Fair share is a stated percentage of debt, to credit counseling organizations that set up and service the DMPs. Credit card companies generally only made the "fair share" payments to organizations recognized as exempt under section 501(c)(3) of the Internal Revenue Code.

The statement of program service accomplishments shown on the Form 990 for 20XX shows that ORG had an active client base of 3,485 on December 31, 20XX. It further states that ORG acquired clients from other credit counseling agencies and is providing debt management services and ongoing education to its clients.

Based on the information provided by ORG the following chart reflects the approximate number of clients at the beginning and end of the three audited years and the percentage that paid reduced or no service fees. The difference in the totals from the end of one year to the beginning of the next year is due to the timing of when the figures were calculated.

ORG	
CLIENTS	3,423
Total at 1-1-20XX	
Total at 12-31-20XX	
Net Increase	

Clients Paying < \$ or No Fees  
Percentage Average for the year

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Tax Periods Ended: December 31,20XX, December 31,20XX & December 31,20XX

Total at 1-1-20XX	4,366
Total at 12-31-20XX	8,278
Net Increase	3,912

Clients paying no enrollment fees  
Clients paying no monthly fees  
Percentage Average for the year

Total at 1-31-20XX	8,164
Total at 12-31-20XX	7,627
Net Decrease	537

Clients paying no enrollment fees  
Clients paying no monthly fees  
Percentage Average for the year

The following table shows the reported total revenue and expenditures from the organization's Forms 990 for the years ended December 31, 20XX through December 31, 20XX.

Year	Total Revenue	Total Expenditures
20XX	\$	\$
20XX	\$	\$
20XX	\$	\$

ORG was governed by a three member board of directors in the years of 20XX - 20XX. The number of board members was increased after 20XX. The Board members were as follows;

<u>Individual</u>		<u>Position</u>
Director-1	20XX, 20XX, 20XX	President, Director (Employee)
Director-2	20XX, 20XX, 20XX	Director
Director-3	20XX, 20XX	Director
Director-4	20XX	Director

Of these persons one is an employee of ORG and the others were from the local community. They are all knowledgeable in financial and debt related matters and at least one is experienced in education and community outreach. There does not appear to be family or business relationships among the ORG board members. In 20XX the non-employee members were compensated \$\$ per year for serving on the board of directors and this was raised in 20XX to \$ for the first quarterly meeting and \$ for each quarterly meeting after that.

The organization presented minutes from a board meeting held in 20XX where the former officers & directors; President & Director-5 and Director-5's mother Director-6 resigned and new officers and directors were elected. President was named as the CEO of ORG and is still in charge of ORG's operations.

During 20 there was not much advertising activity. This increased in 20XX & 20XX. ORG had an Internet website which appeared to emphasize DMPs

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Tax Periods Ended: December 31, 20XX, December 31, 20XX & December 31, 20XX

rather than education in debt or financial matters. It included a link to the client website

The Welcome Page lists the name, address & telephone number, the services offered including "free confidential debt counseling," education, debt management programs, negotiating with creditors, eliminating debt, free budget credit debt financial and housing counseling with bonded certified professional counselors. ORG is a member of national credit counseling associations, CO-7 (CO-7), CO-8 (CO-8) and CO-9 (CO-9).

In 20XX & 20XX the main Welcome Page of the ORG Internet website listed predominately "Free Debt Analysis". The emphasis was on getting out of debt. There are links for the company profile, how consolidation works, counselors, testimonials, contact us and FAQs. There is still the link to the client website, website., and free access to the online "Debt Matters" newsletters. On the current website Welcome Page predominately shown is Enjoy a Debt Free Life, still offers a Free Debt Reduction Analysis, ORG's toll free phone number, shows the states where ORG is licensed, has links offering DMPs, Credit Counseling, Employee Financial Wellness Programs, and Education. ORG obtained some client referrals from the website and other referrals came from word-of-mouth from existing or former clients, however, the largest source of clients was through the lead generation service vendor agreements.

In addition during the year of 20XX ORG contracted with an outside Advertising/Marketing firm to produce TV and radio ads, these were run in both English and Spanish. ORG also contracted with a public relations firm to promote their community image and their credit counseling business.

After enrolling clients in the DMPs ORG provided budgeting and financial information in printed form either in English or Spanish and information was available on ORG's website. In addition ORG offered its clients a free on-line financial literacy course and monthly newsletters called "Debt Matters," were available on-line at no additional cost. A new client was assigned a case manager to help them with questions or account problems and to help the client stay current with their account. The DMP contract is explained fully to the client before it is started. Clients received a Welcome Package, which included a printout of their budget and printed educational materials. Client payments are held in a trust account at a local bank until the monies were transferred to a company called CO-10 who actually made the distribution of the payments to the creditors.

ORG attempted to hire certified credit counselors for their staff to handle the contacts made with clients. If a counselor was not certified they were allowed up to 6 months to obtain their certification through the National Institute for Financial Counseling Education (NIFCE). According to ORG no quotas were established for the counselors and they did not have set target goals for enrolling clients into DMPs. Employees, however, could qualify for a salary bonus for overall good job performance.

ORG was asked by the examining officer on several occasions to provide telephone recordings of conversations between clients and credit counselors. It was stated that no recordings were available for the 20XX or 20XX years. The examining officer was provided a sample of phone call recordings for December 20XX and the first couple of months of 20XX. The purpose of this request was to ascertain the degree of educational information that was being provided by ORG prior to the recommended action for the prospective client. ORG did not provide any record of

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Tax Periods Ended: December 31, 20XX, December 31, 20XX & December 31, 20XX

counselor/client telephone conversations for 20XX or 20XX, therefore it could not be verified that there was any credit or financial information provided or if the counselor was merely enrolling clients in DMPs. Telephone scripts or talking points were requested by the examining officer and he was told ORG did not use them, that the credit counselors only use a Budget Form.

It is common in the credit counseling industry as a part of the credit counselor's discussions with clients to make a determination of the individual's situation and whether or not a DMP is the best option for the client to attempt to get out of their unsecured debt situation. Other options could be bankruptcy, debt settlement, budget modification or credit repair in addition to a DMP. ORG credit counselors speak with clients over the telephone 95 of the time and rarely meet with the clients in face-to-face meetings. The examining officer requested and was provided with a telephone log of incoming and outgoing calls to ORG during the year of 20XX through 20XX. An analysis of this data revealed that the average time of calls in 20XX was only a few minutes. The average call time for the December 20XX calls increased significantly to approximately 40 minutes.

The examining officer requested and was provided with a random sample of 20 client histories from ORG computer program. In these histories when an ORG representative talked with a client a summary of the conversation would be documented. In these documented histories were client budgets, primary and secondary income sources, expenses by category; housing, transportation, food and family expenses, copies of credit card statements, creditor letters, payment transaction history, notes of client contacts, e-mails, correspondence and telephone calls. There is little or no documented education discussions reflected in the sample customer histories other than the counselors mentioning that clients should cut back on expenses or stay within their budgets. The majority of the client contacts deal with client accounts and payment adjustments. Twenty customer account histories were reviewed and of these ten accounts had been transferred from CO-11 and ten had originated with ORG. The twenty account sampling that was reviewed included both active accounts and completed DMPs.

The examining officer was given a file of eleven recorded phone conversations between clients and credit counselors for December 20XX and these were initial contacts and the counselors calls did a much better job of determining the client situation and individual need before recommending an option.

ORG purCO-1d educational materials in bulk and as a part of the effort to educate clients ORG made available the following pamphlets and books;

From the "Making Cents" series of educational materials:

About Checking Accounts

Wise Use of Credit

Securing Financial Needs

Free Online Money Management School

Free Community Workshops

Budgeting and Savings

Your Guide to Homeownership

Understanding Debt

Basics of Credit Cards

Organizing Your Financial Life

Your Guide to Household Budgets, Credit Cards and Electronic Banking

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Debt Guard Money, Debt and Credit  
Guide to Credit and Debt Management, Personal Finance Series by

Financial Information -

The payments received from the clients are deposited in trust accounts until the distribution to the creditors. The following revenue information was compiled from the books and records provided by the organization.

12/31/20XX		
REVENUE	\$ AMOUNT	% OF TOTAL
4020 DC MONTHLY FEES		
4040 DC FAIR SHARE GRANTS		
4050 DC NSF FEES		
4070 DC RESTART FEES		
80 DC ACH PROCESSING FEE		
4090 DC WEB PAYMENT FEE		
4100 DC CHECK BY PHONE FEE		
4150 MISCELLANEOUS INCOME		
4200 CO-4 COMMISSIONS		
INTEREST		
OTHER INCOME		
TOTAL		

The primary activity of ORG in terms of time, revenue and resources is the commercial like operation of enrolling clients in and servicing DMPs. In the year of 20XX 40 of ORG employees were counselors. Only after the DMP clients have paid the first payment to the vendor company and been pre-qualified for a DMP that the ORG counselor has the opportunity to speak to the customer and to learn about the customer's debt situation. At that time, the customer contact only serves the purpose of obtaining the necessary information required for the submission of DMP proposals to the creditors for their approval.

ORG stated in their application for exemption under IRC section 501 (c)(3) that one purpose was to help the public by educating them concerning financial and debt related matters. It is permissible as a part of the educational process that if a customer can benefit from a DMP type arrangement they can be enrolled in one. ORG provided some printed financial education materials to its clients and held seminars for the local community in the 20XX tax year. The amount of education increased during 20XX & 20XX. ORG paid an outside contractor to conduct the educational seminars in the community. The examining officer was given a list of 13 different seminars held in the local community with 180 attendees in 20XX. A schedule of seminars held in the community and evaluations from attendees was provided, the feedback was positive. In addition, an example of a PowerPoint presentation was provided along with the printed educational materials and that provided on the Internet website currently. The emphasis on the website seems to be how to get out of debt. ORG has increased the amounts of direct

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and indirect education in the areas of debt, budgeting and how to better handle financial matters for its clients and perspective clients and the general public as a whole in 20XX & 20XX.

The revenue sources and amounts are very similar for the subsequent years of 20XX & 20XX.

<b>12/31/20XX</b>		
<b>REVENUE</b>	<b>\$ AMOUNT</b>	<b>% OF TOTAL</b>
4020 DC MONTHLY FEES		
4040 DC FAIR SHARE GRANTS		
4050 DC NSF FEES		
4070 DC RESTART FEES		
4080 DC ACH PROCESSING FEE		
4090 DC WEB PAYMENT FEE		
4100 DC CHECK BY PHONE FEE		
4150 MISCELLANEOUS INCOME		
4200 CO-4 COMMISSIONS		
INTEREST		
OTHER INCOME		
<b>TOTAL</b>		

  

<b>12/31/20XX</b>		
<b>REVENUE</b>	<b>\$ AMOUNT</b>	<b>% OF TOTAL</b>
4020 DC MONTHLY FEES		
4040 DC FAIR SHARE GRANTS		
4050 DC NSF FEES		
4070 DC RESTART FEES		
4080 DC ACH PROCESSING FEE		
4090 DC WEB PAYMENT FEE		
4100 DC CHECK BY PHONE FEE		
4150 MISCELLANEOUS INCOME		
4200 CO-4 COMMISSIONS		
INTEREST		
OTHER INCOME		
<b>TOTAL</b>		

\* The information for the 20XX tax period is based on the information provided by ORG. There is not an IRS record of the 20XX Form 990 being received.

Form 886-A

ORG

EIN: EIN

Tax Periods Ended: December 31, 20XX, December 31, 20XX & December 31, 20XX

During 20XX and continuing through the year of 20XX ORG paid for client leads and purCO-1d existing clients from other CO-3, including [redacted], Inc. and [redacted] CO-4 ORG was requested to provide information on how many clients were obtained from other CO-3 in 20XX, 20XX & 20XX and the total was 6,938 and of this number 5,949 made payments to ORG. (It is unknown what happened with clients who did not make payments to ORG.)

In an outright purCO-1 of customer DMPs from [redacted] CO-4 ORG paid \$ [redacted] in October of 20XX. This transaction was shown in the Client Acquisition Account of ORG's general ledger.

At least two new vendor contracts for the acquisition of clients by paying fees were entered into after the effective date of IRC Section 501(q)—one in October of 20XX and another one in September of 20XX. In the year of 20XX approximately \$ [redacted] was paid in fees to various vendors for lead generation services. The fees are shown as Marketing in ORG's general ledger accounts. In 20XX the general ledger accounts reflect vendor payments shown in the Marketing and also Marketing Expenses - Other Accounts. These payments were approximately \$ [redacted] and \$ [redacted] respectively.

ORG stated that they were asked to take over some DMP clients from other consumer credit counseling agencies that went out of business or lost their tax exempt status at the request of the State of State and creditors for the benefit of the clients enrolled in DMPs so they could continue in their existing DMPs. These transferred from other credit counseling agencies for the clients' benefit did not involve fees paid to or by ORG. They would just begin collecting the normal monthly servicing fees.

As verified by documents and information provided by ORG several of the officers and staff of ORG attended CO-7 and CO-9 conferences several times each year during the years of 20XX, 20XX & 20XX. The enactment of section 501(q) was only one change among others affecting regulating the credit counseling industry as a part of the Pension Protection Act of 20XX. ORG presented copies of the seminar materials and these changes were covered at many of these conferences. ORG also hired a "compliance consultant" in May of 20XX to help them stay compliant with federal and state laws and regulations.

**Law:**

Section 501 (a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from federal income tax. Section 501 (c)(3) of the IRC 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. The term charitable includes relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2), of the Treasury Regulations.

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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. Treas. Reg. §1.501(c)(3)-1(d)(3).

Section 1.501 (c)(3)-1(a)(1) of the treasury 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 cannot be tax-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 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(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 1.513-1(d)(4)(iv) of the regulations recognizes that in certain cases, activities carried on by an organization in the performance of exempt functions may generate good will or other intangibles, which may be exploited in commercial endeavors. Where an organization exploits such an intangible in commercial activities, the mere fact that the resultant income depends in part upon an exempt function of the organization does not make it gross income from related trade or business. In such cases, unless the commercial activities themselves contribute importantly to the accomplishment of an exempt purpose, the income, which they produce, is gross income from the conduct of unrelated trade or business. Example 7 of this section describes advertising by business firms in an exempt organization's journal that promotes only products that are within the general area of interest of the organization's members. The example indicates that the advertising is not an educational activity of the kind contemplated by the exemption statute and that, therefore, the organization's publication of advertising does not contribute importantly to the accomplishment of its exempt purposes.

IRC §501(q) was enacted into law in 20XX as a part of the Pension and Protection Act. This section placed additional requirements on consumer credit counseling agencies beginning on January 1, 20XX.

501(q) Special rules for credit counseling organizations.--

(1) In general.--An organization with respect to which the provision of credit counseling services is a substantial purpose shall not be exempt from tax under subsection (a) unless such organization is described in paragraph (3) or (4) of subsection (c) and such organization is organized and operated in accordance with the following requirements:

(A) The organization--

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- (i) provides credit counseling services tailored to the specific needs and circumstances of consumers,
  - (ii) makes no loans to debtors (other than loans with no fees or interest) and does not negotiate the making of loans on behalf of debtors,
  - (iii) provides services for the purpose of improving a consumer's credit record, credit history, or credit rating only to the extent that such services are incidental to providing credit counseling services, and
  - (iv) does not charge any separately stated fee for services for the purpose of improving any consumer's credit record, credit history, or credit rating.
- (B) The organization does not refuse to provide credit counseling services to a consumer due to the inability of the consumer to pay, the ineligibility of the consumer for debt management plan enrollment, or the unwillingness of the consumer to enroll in a debt management plan.
- (C) The organization establishes and implements a fee policy which--
- (i) requires that any fees charged to a consumer for services are reasonable,
  - (ii) allows for the waiver of fees if the consumer is unable to pay, and
  - (iii) except to the extent allowed by State law, prohibits charging any fee based in whole or in part on a percentage of the consumer's debt, the consumer's payments to be made pursuant to a debt management plan, or the projected or actual savings to the consumer resulting from enrolling in a debt management plan.
- (D) At all times the organization has a board of directors or other governing body--
- (i) which is controlled by persons who represent the broad interests of the public, such as public officials acting in their capacities as such, persons having special knowledge or expertise in credit or financial education, and community leaders,
  - (ii) not more than 20 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the repayment of consumer debt to creditors other than the credit counseling organization or its affiliates), and
  - (iii) not more than 49 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees).
- (E) The organization does not own more than 35 percent of--
- (i) the total combined voting power of any corporation (other than a corporation which is an organization described in subsection (c)(3) and exempt from tax under subsection (a)) which is in the trade or business of lending money, repairing credit, or providing debt management plan services, payment processing, or similar services,
  - (ii) the profits interest of any partnership (other than a partnership which is an organization described in subsection (c)(3) and exempt from tax under subsection (a)) which is in the trade or business of lending money, repairing credit, or providing debt management plan services, payment processing, or similar services, and
  - (iii) the beneficial interest of any trust or estate (other than a trust which is an organization described in subsection (c)(3) and exempt from tax under subsection (a)) which is in the trade or business of lending money, repairing credit, or providing debt management plan services, payment processing, or similar services.

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

(2) Additional requirements for organizations described in subsection (c)(3).--

(A) In general.--In addition to the requirements under paragraph (1), an organization with respect to which the provision of credit counseling services is a substantial purpose and which is described in paragraph (3) of subsection (c) shall not be exempt from tax under subsection (a) unless such organization is organized and operated in accordance with the following requirements:

- (i) The organization does not solicit contributions from consumers during the initial counseling process or while the consumer is receiving services from the organization.
- (ii) The aggregate revenues of the organization which are from payments of creditors of consumers of the organization and which are attributable to debt management plan services do not exceed the applicable percentage of the total revenues of the organization.

(B) Applicable percentage.--

- (i) In general.--For purposes of subparagraph (A)(ii), the applicable percentage is 50 percent.
- (ii) Transition rule.--Notwithstanding clause (i), in the case of an organization with respect to which the provision of credit counseling services is a substantial purpose and which is described in paragraph (3) of subsection (c) and exempt from tax under subsection (a) on the date of the enactment of this subsection, the applicable percentage is--
  - (I) 80 percent for the first taxable year of such organization beginning after the date which is 1 year after the date of the enactment of this subsection, and
  - (II) 70 percent for the second such taxable year beginning after such date, and
  - (III) 60 percent for the third such taxable year beginning after such date.

(3) Additional requirement for organizations described in subsection (c)(4).--In addition to the requirements under paragraph (1), an organization with respect to which the provision of credit counseling services is a Substantial purpose and which is described in paragraph (4) of subsection (C) shall not be exempt from tax under subsection (a) unless such organization notifies the Secretary, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition as a credit counseling organization.

(4) Credit counseling services; debt management plan services.--For purposes of this subsection--

- (A) Credit counseling services -- The term "credit counseling services" means--
- (i) the providing of educational information to the general public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of consumer credit,
  - (ii) the assisting of individuals and families with financial problems by providing them with counseling, or
  - (iii) a combination of the activities described in clauses (i) and (ii),

(B) Debt management plan services.--The term "debt management plan services" means services related to the repayment, consolidation, or restructuring of a consumer's debt, and includes the negotiation with creditors of lower interest rates, the waiver or reduction of fees, and the marketing and processing of debt management plans.

In *Solutions Plus, Inc., v. Commissioner of Internal Revenue Service*, T.C. Memo. 20XX-21, 20XX WL 312764 (US Tax Ct 20XX), the tax court held that the taxpayer failed both the

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organizational and the operational tests for tax exemption and was operated for substantial non-exempt purposes.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 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 purchase of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

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

The Internal Revenue Service has issued two rulings holding credit counseling organizations to be tax exempt. Revenue Ruling 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 meeting with 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.

In Revenue Ruling 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, holding the funds in a trust account and disbursing 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 contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The IRS 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.

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 educating the public on subjects useful to the individual and beneficial to the community. 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 participants in the DMP received full credit against their debts for the amounts paid. Moreover, the agencies charged a nominal fee of up to \$10 per month for the DMP. This fee was waived in instances when payment of the fee would work a financial hardship. 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, 1976-1 C.B. 154 (free

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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.

In Easter House v. U.S., 12 Ct. Cl. 476 (1987), aff'd 846 F.2d 78 (Fed. Cir 1988), the court found that adoption services were the primary *activity* of the organization. In deciding that the organization conducted adoption services for a business purpose rather for a charitable purpose, the court considered the manner in which the organization operated. The record established a number of factors that characterize a commercial activity and which were evident in the operations of Easter House also. The court determined that the organization competed with other commercial organizations providing similar services; fees were the only source of revenue; it accumulated *very* substantial profits, because it set its fees in order to generate a profit; the accumulated capital was substantially greater than the amounts spent on charitable and educational activity; and the organization did not solicit and did not plan to solicit contributions. The court also found a corporate-type structure in the classes of memberships (including a single life member having inherent power that the holder could transfer like stock), and dependence on paid employees. The court also agreed with the IRS' determination that the agency operated in a manner not "distinguishable from a commercial adoption agency" because it lacked the following traditional attributes of a charity. First, the agency's operation made substantial profits, and there was a substantial accumulation of capital surplus in comparison to direct expenditures by the agency for charitable and educational purposes. Second, the agency's operation was funded completely by substantial 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. In fact, the agency had no plans, nor intention to seek contributions, government grants or engage in fund raising relative to its operations. Third, the fixed fees the agency charged adoptive parents were not subject to downward adjustment to meet potential adoptive parents' income or ability to pay. Fourth, the agency's single life member had near total control of the operations of the agency. And fifth, the agency functioned by means of a paid staff of 15 to 20 persons, with no volunteer help.

The Credit Repair Organizations Act (CROA), 15 U.S.C. § 1679 et seq., effective April 1, 1997, imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 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

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service described in clause (i).

The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re National Credit Management Group, LLC, 21 F. Supp. 2d 424,458 (N.D.N.J. 1998).

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission. 16 C.F.R. § 310.4(b)(1)(iii)(B); 47 C.F.R. § 64.1200(c)(2). Section 501(c)(3) organizations are not subject to this rule against cold-calling. Because 501(c)(3) organizations are exempt from regulation under the CROA and the cold-calling restrictions, organizations that are involved in credit repair have added incentives to be recognized as section 501(c)(3) organizations even if they do not intend to operate primarily for exempt purposes.

### Government Position:

#### Issue 1:

It is the government's position that ORG's exempt status should be revoked because ORG paid fees in the years of 20XX & 20XX to acquire clients for the purpose of enrolling them in DMPs in violation of IRC section 501(q)(1)(F). In addition, ORG entered into new contracts in October of 20XX and September of 20XX to acquire clients for this purpose. It is the government position that this violation in the years of 20XX and 20XX is grounds for revocation of the organization's tax exempt status.

The Pension and Protection Act of 20XX contains provisions to help regulate consumer credit counseling agencies. One of those provisions, which is effective for tax years beginning on January 1, 20XX, consumer credit counseling agencies are prohibited from paying or receiving fees in connection with obtaining clients, according to IRC section 501(q). ORG generated clients through their own efforts, but ORG continued to pay fees to obtain large numbers of referrals through the lead generation vendor contracts in violation of IRC section 501 (q). In addition in October of 20XX approximately 4,500 DMP clients were purCO-1d from CO-4 for \$.

The primary source of ORG clients was through the lead generation companies. The dollars spent on lead generating vendors in the years of the audit were \$ in 20XX, \$ in 20XX and \$ in 20XX. From a strictly financial perspective DMPs were critical to ORG to be able to continue to operate or even exist.

#### Issues 2 & 3:

It is the government's position that during the years of 20XX - 20XX ORG was not operated exclusively for educational or any other charitable purpose as defined in IRC section 501(c)(3), because it engaged in activities in furtherance of non-exempt purposes to more than an insubstantial degree.

The primary activity of ORG for the years of 20XX through 20XX was enrolling pre-qualified individuals in fee-for-service DMPs and the servicing of DMPs. Educational information was

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provided, but it has not been demonstrated to be their primary activity. The educational activity of the taxpayer has increased through the years since 20XX, however, it is still an incidental amount compared to the DMP activity and purchasing of other credit counseling agencies' DMPs. Little if any education was demonstrated in the (1) enrolling in DMPs or (2) acquiring other agencies' DMP clients. The average call times were only a few minutes in 20XX, not enough time to fairly evaluate a client's situation and be able to make a proper recommendation for action.

The education provided was incidental to a client's DMP enrollment. In addition, there was a low percentage of individuals who paid little or no fees for their DMPs. There were obstacles to having a waiver of or reduction of fees. Any request for a reduction or waiver of fees was referred to management to make a determination at a later date whether or not a client was eligible.

ORG applied for and received the creditor fair share payments. In 20XX through 20XX tax exempt status was necessary in order to receive these fair share payments. As another indication of the commercial like nature of ORG's operation, letters were sent out to other credit counseling agencies in an effort to solicit the purCO-1 of clients and to increase its revenue stream. ORG also obtained clients from liquidating or revoked credit counseling agencies. The clients originating with ORG were almost entirely pre-qualified referrals as a result of the vendor contracts and ready to be enrolled in a DMP to get out of their debt situation.

ORG did not meet the test of an educational organization as defined under the Internal Revenue Code, its Regulations or legal precedence. The primary activity was the enrollment of debtors in DMPs and the servicing of DMP accounts. The operational test as stated in section 501 (c)(3) of the Internal Revenue Code has not been met because more than an insubstantial part of its activities were commercial in nature during 20XX through 20XX. By definition, IRC section 501 (c)(3) organizations will only qualify for tax exempt status if it is organized and operated exclusively for charitable purposes. To meet the requirement it is necessary for an organization to establish that it is organized and operated for the benefit of the public and not for private interests. It is the government position that ORG was operating to establish and service DMPs in a commercial like manner, which is not an exempt activity as described under IRC section 501 (c)(3).

In Solutions Plus, Inc. v. Commissioner of Internal Revenue Service, T.C. Memo, 20XX-21, 20XX WL 312764 (U S Tax Ct. 20XX), the tax court held that the taxpayer failed both the organizational and operational tests for tax exemption and was operated for substantial non-exempt purposes. ORG is not unlike this organization because it primarily offered DMP services to the public and did not provide meaningful educational materials prior to DMP enrollment.

ORG is not like the credit counseling organization in Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), as the organization described in this case charged no fees in relation to the educational activity and only nominal fees for the debt consolidation services that were provided. They received charitable contributions, private and government grants to support their operations. The counselors spent approximately 12% of their time on DMP activities and 88 of their time on counseling clients and educational type activity. The government position is that ORG's educational and charitable activities were not

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substantial in comparison to the services provided to its clients through DMP enrollments, which was a substantial activity.

ORG is not like the credit counseling organization described in Revenue Ruling. 69-441. The organization described in this ruling charged no fees in relation to the educational or debt consolidation services that were provided. They received contributions to support their operations from the creditors participating in the organization's budget plans. The government position is that ORG's educational and charitable activities were not substantial in comparison to the services provided to its clients through DMP enrollments, which was a substantial activity. ORG charged fees as allowed by the various state laws and received no contributions of any kind.

ORG's activities differ from those of the organization in Revenue Ruling. 65-299. ORG did not primarily further an exempt purpose. There were little or no fees being waived and there were no public contributions of support. Most all of the funding comes from DMP related fees. ORG carried on educational programs during 20XX through 20XX, but these were not deemed to be primary activities as required by IRC section 501(c)(3). There was no evidence presented of actual counseling prior to enrollment in the DMPs until the last few months of 20XX. The primary evidence of education was in the form of printed materials provided after the enrollment in the DMP. Educational materials were available through the Internet website and clients could call their case manager at any time to get assistance with their account. Unlike the credit counseling organization described in the Revenue Ruling referred to above, and in Consumer Credit Counseling Service of Alabama, Inc. v. U.S., during the period of audit ORG did not provide the level of counseling or education to meet the education standard for tax exempt status.

ORG is similar to the organization described in *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978), where an organization providing consulting services was not granted exemption because of the commercial nature of its operation. The organization did not solicit or receive any charitable contributions from the public as a normal charitable organization WOULD, rather the income was from fees for services high enough to cover the operating costs and generate a profit.

ORG is similar to the organization denied exemption in *Easter House v. U.S.*, 12 Ct. Cl. 476 (1987), *affd* 846 F.2d 78 (Fed. Cir 1988). In this case the court found that the primary activity of the organization was conducting services for a business purpose rather for a charitable purpose. The court considered the manner in which the organization operated. The record established a number of factors that characterize a commercial activity and which were evident in the operations of Easter House. The court determined that the organization competed with other commercial organizations providing similar services; fees were the only source of revenue; it accumulated very substantial profits, because it set its fees in order to generate a profit; the accumulated capital was substantially greater than the amounts spent on charitable and educational activity; and the organization did not solicit and did not plan to solicit contributions. The court found a dependence on paid employees, the agency functioned by means of a paid staff of 15 to 20 persons, with no volunteer help.

CROA was enacted to protect consumers by banning certain deceptive practices in the credit counseling industry. If ORG was a for-profit company the CROA would prohibit it from charging fees in advance of fully providing services. In addition, if ORG were for-profit federal law would

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prohibit it from purchasing leads and making cold calls to potential customers. Because section 501 (c)(3) organizations are exempted from the provisions of CROA ORG is able to engage in business practices that Congress intended to prohibit when it passed CROA. As such, ORG is operated for a substantial non-exempt purpose, that of carrying on a business while avoiding certain federal regulations. In addition, ORG could not collect "fair share" payments from creditors if it did not have tax-exempt status. A substantial source of revenue in the DMP business depends on an organization having tax-exempt status.

ORG has continued to conduct educational activity in increasing amounts over the years from the 20XX through 20XX. However, more than an insubstantial part of its activities continued to be the commercial like business of enrolling clients in DMPs and servicing those DMP client accounts.

**Taxpayer Position:**

After the proposed revocation of the 20XX tax year ORG advised the IRS that although there may have been some short falls in the earlier years they have made corrections and improved the operation to the point that they now are following the IRS guidelines. ORG believes that their educational efforts have been greatly enhanced since 20XX and that their primary activities meet the requirements of exemption from federal income tax under IRC section 501(c)(3) and enrolling persons in and servicing DMPs is only a part of their business activities.

The organization helps people who are in financial distress and behind on their bills to get out of their debt situation and they help to educate their clients in financial and credit matters. They conducted an increasing number of seminars at schools and in the local community of south State. Their Internet website provides educational information and printed educational materials are sent to clients free of charge on request. The company has a favorable rating with the Better Business Bureau.

ORG holds licenses in many states, provides industry concerns to state legislators and maintains a national presence in the Debt Management Industry. ORG is a State of State not-for-profit corporation.

Like much of the industry, ORG, has changed much of its operations to be more compliant with the rules and regulations under IRC section 501(c)(3). Actions have been taken by ORG during the IRS examinations to ensure compliance, including removing officers responsible for bad acts, reorganizing the Board of Directors to properly divest control to unrelated individuals and the increased educational outreach in the community.

**Conclusion:**

In the years of 20XX through 20XX ORG was not operated exclusively for educational or any other charitable purpose within the meaning of section 501(c)(3) of the IRC because it did not engage primarily in activities that accomplished an exempt purpose. In the years of 20XX through 20XX more than an insubstantial part of ORG's activities were operating for the commercial like non-exempt purpose of enrolling persons in DMPs and the servicing of DMPs.

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The amount of credit and financial management education being provided to the public has increased in the years after 20XX into the years of 20XX and 20XX, however, ORG was in violation of IRC section 501(q) by continuing to pay fees in connection with obtaining client leads and also paying fees to obtain existing clients from other consumer credit counseling agencies. ORG has provided copies of contracts which indicate that they entered into at least two new contracts for client acquisitions for a fee after the January 1, 20XX effective date of IRC section 501(q). Accordingly, it is determined that ORG was not an organization described in section 501(c)(3) and should have its exemption from federal income tax under section 501(c)(3) of the IRC revoked effective January 1, 20XX.