



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **200649035**

Release Date: 12/08/2006

Date: September 13, 2006

UIL: 501.00-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

1120

Tax Years:

All

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since you withdrew your protest, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

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



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: August 30, 2005

UIL: 501.00-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

Dear _____ :

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

You were originally formed as a for-profit corporation by D, who was the corporation's sole trustee, registered agent, and incorporator. The for-profit entity was subsequently dissolved and you were formed as a not-for-profit corporation. D provided you with start-up funding of \$ _____. The information you submitted projects that D will be a compensated employee and is to receive more than _____ percent (\$ _____ / \$ _____), of your projected revenue in the form of personal compensation in year two of your operations. In year three, D is projected to receive _____ percent (\$ _____ / \$ _____) of your revenue in personal compensation. In your Articles of Incorporation, you state that the purposes for which you are formed include, but are not limited to, "educating individuals on issues of financial planning; providing debt counseling; and providing debt management services." You wish to be classified as a publicly supported organization under section 509(a)(2) of the Code.

According to your website (see attached), you "provide counseling and debt management plans (DMPs) for those who are experiencing financial difficulties. The DMP allows you to make one easy affordable monthly payment." You represent that your employees will spend approximately _____ percent of their time administering the DMP. Participants in the DMP are charged a one-time set-up fee of \$ _____, and a monthly handling fee of _____ percent of the client's total monthly payment to creditors not to exceed \$ _____ per month. After you set up the client on a DMP, the customer service staff provides the follow-up administration and servicing of the account. The follow-up responsibilities include: inputting all information on the clients and

their debts in a database system, notifying the clients to send in their monthly billing statements from their creditors, mailing out monthly itemized progress reports, and handling all incoming calls from clients as well as from creditors.

You state that "for each consultation all clients will receive a 60-90 minute session with a credit counselor or longer if needed due to each client's unique financial situation." However, you also state that your employees work an 8 to 9 hour day, answer 3 to 10 calls per hour, and make and answer 24 plus calls per day. You represent that you will not limit your services to a particular class of people, but will provide services to individuals who need budgeting and financial education.

You represent that your sources of financial support include client fees and corporate donations. In addition, you may receive fair share contributions from creditors. You plan to develop corporate training accounts and solicit donations from those accounts. However, you have failed to provide evidence that you have received corporate donations or that you have a substantive plan to receive these types of donations in the future. According to your Debt Management Agreement, "creditors have a financial interest in being paid, and many are willing to make contributions to help fund [you]. Client understands that [you] accept funding from voluntary contributions from creditors who participate in debt management programs, and that **[you] work for both clients and creditors.**" (*Emphasis Added*).

In your first year of operations, you project that percent of your expenses will be allocated for advertising expenses. In year two, percent of your expenses will be allocated for advertising expenses, and in year three, percent of your expenses will be allocated for such expenses. Initially, you will advertise in the yellow pages. An advance copy of your yellow pages' advertisement includes the following language: "Avoid Bankruptcy...Improve Debt to Income Ratio...Bring Delinquent Accounts Current...Eliminate Late and Over Limit Fees...Reduce Finance Charges by % - %...Payoff Credit Card Debts In 4-5 Years, Instead of 20-30!!!!...Free Budget and Debt Counseling...With Close Personal Service...Put Your Credit Report In Order..."

B will provide information technology and back-end services to you by custom designing your software and processing the debt management payments received by your clients. Its owner and president is C, who is one of your directors. There is no evidence in the administrative record that you considered other entities when deciding which business to provide you with such services. There is also no evidence in the record that you are paying B a reasonable sum of money for its services.

You represent that you will provide educational courses covering topics relating to managing personal day-to-day financing and money management, general budgeting, saving for a rainy day, balancing checkbooks, impulse buying, bargain shopping, the dangers of immediate gratification, and self discipline. You will conduct these sessions at no cost to the participants. You also represent that your employees will spend approximately percent of their time providing educational seminars to individual who are potential/existing DMP participants, and approximately percent to individuals who are not potential DMP participants. After the client has enrolled in a DMP, you represent that "clients then will be given time and dates to attend educational seminars, follow-up appointments to re-examine their budgets, if there were any income changes or large unexpected changes in their finances, learning tools, educational materials, and resources designed to help each client manage their money."

You have not provided educational materials because you are still developing them. In fact, there is no information in the administrative record with respect to the dates and times of the seminars, the agenda, the literature describing the seminars, and how you will integrate these seminars into your operations. Moreover, you have failed to budget funds for educational materials, workshops, or programs.

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

Section 1.501(c)(3)-1(b)(iii) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3).

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(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

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

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part

of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance 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 an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed arguendo that the organization had an educational purpose. However, the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was indicative of a business. Therefore, the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

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

The Consumer Credit Counseling Service, which had been recognized as exempt under section 501(c)(3) in a group ruling, is an umbrella organization made up of numerous credit counseling service agencies. In this case, these agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. The professional counselors used only percent of their time for debt management programs. They did not limit these services to low-income individuals and families, but they provided their services free of charge. The court found that the law did not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under section 501(c)(3). Nonetheless, these agencies did not charge a fee for the programs that constituted their principal activities. A nominal fee was charged for the debt management services but was waived when payment would work a financial hardship.

The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from fees. Thus, the court concluded that "each of the plaintiff consumer credit counseling agencies was an organization described in section 501(c)(3) as a charitable and educational organization." See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S. Tax Cas. 9468 (D.D.C. 1979), in which the facts were virtually identical and the law was identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), an organization operated bingo at a bar (a for-profit enterprise) for purposes of raising money for scholarships. The board of directors included the bar's owners and accountant, and two other persons. The court reasoned that, because the bar owners controlled the organization and appointed its directors, the organization's fundraising activities could be used to the advantage of the bar owners, and thus, provide them with a maximum private benefit.

The organization claimed that it was independent because there was a separate accounting and that no payments were going to the bar. The court maintained that the organization's and the bar's activities were so interrelated as to be "functionally inseparable." A separate accounting did not change that fact. Thus, the organization did not operate exclusively for exempt purposes, but rather benefited private interests – the bar owners. Exemption was properly denied.

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.

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.

Based on our analysis of the information you submitted during the application process and in light of the applicable law, we have determined that you do not meet the requirements under section 501(c)(3) because you are not appropriately organized as a tax-exempt organization. (See section 1.501(c)(3)-1(b)(1)(iii) of the regulations). According to your Articles of Incorporation, you are formed to provide debt counseling and debt management services, among other things. These purposes are not tax-exempt purposes within the meaning of section 501(c)(3) of the Code.

You also operate for substantial non-exempt commercial purposes in contravention of section 501(c)(3). (See, Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), in which 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.) At least forty percent of your activities are devoted to selling and maintaining DMPs to the general public for a fee. In fact, your customer service employees' responsibilities are specifically focused on the DMP operations. Your promotional material, including your Internet site, also encourages the use of DMPs by eliminating late and over limit fees, reducing finance charges, and allowing you to make one easy affordable monthly payment. Furthermore, you allocate \$ to \$ in advertising expenses per year, accounting for an average of percent of your total expenses. You also represent that you will not limit your services to a particular class of people, but will provide services to the general public. You are unlike the organization described in Rev. Rul. 69-441, 1969-2 C.B. 115, which aided low-income individuals and families who have financial problems, thereby relieving the poor and distressed. The organization described in the Rev. Rul. also provided, without charge, education and counseling.

Your financial structure does not resemble that of a typical charity because it is based entirely upon revenue earned by selling services to the public as well as fair share contributions based on services provided to the creditors receiving payments through your DMP. You expect to receive most of your contributions from creditors. Although you represent that your financial support will also include corporate donations, you have failed to provide evidence that you received such donations or that you have a substantive plan to receive these types of donations in the future. There is no evidence that you receive contributions or gifts from disinterested members of the public. Thus, you are unlike the organizations described in Consumer Credit Counseling Service of Alabama, Inc. v. United States, supra, that received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from fees.

Although you maintain that you will provide courses and seminars focusing on money management and budgeting, you have failed to substantiate that you follow an educational methodology. You did not provide specific information about your seminars (i.e. agenda, literature describing the seminars, and dates and times of the seminars), as well as how you will integrate these seminars into your operations. You have also failed to budget funds for educational materials, workshops, or other educational programs. Your advertising is focused on marketing your DMP operations, and your expenses for advertising for the first three years average percent of your total expenses.

You represent that employees will spend approximately percent of their time providing educational seminars to individual who are potential/existing DMP participants, and approximately percent to individuals who are not potential DMP participants. After the client has enrolled in a DMP, you state that "clients then will be given time and dates to attend educational seminars, follow-up appointments to re-examine their budgets, if there were any income changes or large unexpected changes in their finances, learning tools, educational materials, and resources designed to help each client manage their money." However, you have also failed to substantiate the manner in which these educational initiatives are integrated into your operations. Even if some of your activities may be educational, it is clear from your own description that your primary purpose is the sale of DMPs. Accordingly, we conclude that you are not operated exclusively for exempt purposes within section 501(c)(3) because you

have a substantial non-exempt purpose. (See American Institute for Economic Research v. United States, supra, in which the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.)

In addition to operating for a substantial non-exempt purpose, you also confer substantial private benefits on the credit card companies. You are operating as a collection agency for these companies. You state in your Debt Management Agreement that "creditors have a financial interest in being paid, and many are willing to make contributions to help fund [you]." In fact, you even state that **[you] work for both clients and creditors** (*Emphasis Added*). 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. These companies clearly realize substantial financial benefits through their business relationship with you.

In addition, we are unable to conclude that your earnings don't inure to the private interests of C, as one of your directors and owner and president of B, which provides you with information technology services by custom designing your software and processing the debt management payments received by your clients. B is otherwise known as your back-end service provider. (See section 1.501(c)(3)-1(d)(1)(ii) of the regulations). There is no evidence in the administrative record that you even considered other entities when deciding which business to provide you with such services. Furthermore, there is no evidence in the record that you are paying B a reasonable sum of money for its services. Thus, we cannot conclude that C is not receiving a substantial benefit as owner and president of B because of the services that B is providing you and the payment it receives in return.

And finally, we have determined that you operate to further a private purpose rather than to benefit the public as a result of your relationship with your founder (D). D formed you initially as a for-profit corporation, while acting as the sole trustee, registered agent, and incorporator. Although you were dissolved and later formed as a not-for-profit entity, D continues to exercise control over your operations by providing the bulk of your start-up funds, acting as your President/CEO and receiving much of your projected revenue as compensation. We are unable to conclude that you are not operated as D's alter-ego business. (See P.L.L. Scholarship Fund v. Commissioner, supra).

In summary, you do not meet the requirements under section 501(c)(3) because you failed both the organizational and operational tests. Because your primary purpose is to sell DMPs rather than to educate and counsel the general public as evidenced by the fact that you have not established an educational methodology, we find that you operate primarily for non-exempt commercial purposes. In addition, we have determined that you operate for the private interests of C as well as the credit card companies, and for private purposes because of your relationship with your founder. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted.

You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If it is convenient, you may fax your reply using the fax number shown in the heading of this letter. If you fax your reply, please contact the person identified in the heading of this letter by telephone to confirm that your fax was received.

Internal Revenue Service
TE/GE
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437