



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **200649036**
Release Date: 12/08/2006
Date: September 15, 2006

UIL: 9999.98-00

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 under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(3).

We made this determination for the following reason(s):

You are not organized or operated exclusively for exempt purposes. Also, you have failed to establish that you do not operate for a substantial nonexempt purpose.

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.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date that we mailed this letter to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

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, you should 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: January 27, 2006

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND

X =

Dear :

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

Facts

You were incorporated in February 2005, according to your Articles of Incorporation, with a specific purpose to:

Promote financial literacy to highly leveraged consumers who want to become debt free. Offer products and services to assist the consumers in reaching their financial goals.

Your By-laws list as specific objectives and purposes:

1. Establish X as a viable and beneficial entity in the credit counseling industry through expanded financial services and diversification of revenue.
2. Provide a financial literacy model that focuses on increasing consumer financial awareness and preventing financial distress.
3. Provide a structured debt repayment plan (debt management program) for the immediate and long-term relief of financially overburdened consumers.
4. Establish X as a reliable corporate community support mechanism for those in need.

You are currently "non-operational" while "obtaining our Non-Profit 501(c)(3) status which will enable us to launch our DMP platform and begin to function as a functioning entity in the DMP marketplace." When you begin operations, you will perform all of the services necessary to sell and maintain DMPs yourself, rather than contracting out the backend.

Many of the details of your operations are undetermined. You have not secured start-up capital, you do not have an office or a website. You have not drafted customer agreements, employee handbooks, or educational materials. Your only employee is your president. However, you did provide a detailed "script" that you intend to give to your employees to follow while conducting telephone calls with prospective clients.

The script is entirely devoted to selling debt management plans. After answering the telephone by identifying himself, the employee immediately mentions DMPs, "Now before I can determine your qualification for the DMP, I will need to ask you several questions..." After asking about employment and debts, the employee tells the caller, "In order to qualify for our program...you will need to have at least \$2000 in Unsecured Debts and you will need to have 2 Accounts or more on the program." The employee is not directed to ask about the caller's broader financial situation, about anyone else in the household (unless they are jointly responsible for the unsecured debt), secured debt or about underlying non-financial problems. The caller is not assisted in making a budget. Alternative approaches to debt management are not proposed or discussed. If a caller has either too much or too little disposable income, he is advised to call his creditors directly to make other arrangements and the call is ended.

You state that you are developing educational pamphlets that you "will mail monthly to [your] Customers which focus on financial literacy and provide tools and information which can further enhance the knowledge of financial soundness to [your] Customers." You also plan to offer your "Educational Solutions platform" to high school and college students, free of charge by your employees. However, you did not submit even drafts of any of this material.

After your DMP operations become "viable," you may add some additional activities. You may seek and "receive referral fees for Products and Services that we market appropriately to our Potential Customers." (Correspondence # 2c) For example, you may refer a caller who does not meet the qualifications for a DMP, but owns a home, to a vendor for mortgage re-finance, and receive a "marketing fee for generating that particular lead." (Correspondence #2c) You may expand to offer credit repair in the future, or refer to an outside vendor of those services. (Correspondence # 11) A long-term goal is to have credit card companies extend additional credit to your DMP customers. (Correspondence # 24)

Revenue will flow from fair share payments by creditors and from voluntary contributions by clients. The client will not be asked for up-front payments, but will be asked to contribute \$5 per account, per month up to a total of \$25 per month.

You will use several methods to attract clients. Primarily, you will use "traditional advertising that has lead [sic] to maximum lead generation for the Credit Counseling Industry...Internet Ads and Print Media." (Correspondence # 11) In addition, you intend to build networks with organizations that offer HUD's homebuyer certification programs. You note that participants in these programs generally have credit issues that they are motivated to resolve. You will also offer financial literacy seminars to adult education institutions which will give you "an opportunity

to expose our DMP platform to Prospective Customers who may not have heard about Credit Counseling via [your] traditional Marketing Channels." (Correspondence # 13) You hope to generate sufficient clients by these methods. However, you have researched companies that sell specific credit counseling leads, and will purchase leads if necessary "to maintain [your] revenue goals." (Correspondence # 29)

There are two directors on your board, a husband and wife. The husband, also the president, has worked in the credit counseling industry for some time.

Law

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

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

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in 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 assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and specifically that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the relief of the poor and distressed or of the under privileged 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, were 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.T.C. 9660 (D.D.C. 1978), the court held that an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational.

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

nominal fee of up to \$10 per month for the debt management plan. This fee was waived in instances when payment of the fee would work a financial hardship.

The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from service fees.

The court found the organizations exempt under section 501(c)(3) because providing information to the public regarding the sound use of consumer credit is charitable in that it advances and promotes education and social welfare. These programs were also educational because they instructed the public on subjects useful to the individual and beneficial to the community. The counseling assistance programs were likewise charitable and educational in nature. Because the community education and counseling assistance programs were the agencies' primary activities, the agencies were organized and operated for charitable and educational purposes. The court also concluded that the limited debt management services were an integral part of the agencies' counseling function, and thus charitable, but stated further that even if this were not the case, these activities were incidental to the agencies' principal functions.

Finally, 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) or to provide its services solely without charge. Nonetheless, these agencies did not charge a fee for the programs that constituted their principal activities. They charged nominal fees for services that were incidental. Moreover, even this nominal fee was waived when payment would work a financial hardship.

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.

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, 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 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.

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free marriage counseling); Rev. Rul. 68-71, 1968-1 C.B. 249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

Rev. Proc. 90-27, 1990-1 C.B. 514, provides in part, that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere statement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned, and the nature of the contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or determination letter will be issued. In those cases where an organization is unable to describe fully its purposes and activities, a refusal to issue a determination letter will be considered an initial adverse determination from which administrative appeal or protest rights will be afforded.

Rationale

You are neither organized nor operated exclusively for exempt purposes. Furthermore, you have not established that your operation will not result in private benefit or inurement to private individuals.

The Internal Revenue Code requires every organization that receives exemption from federal income tax under section 501(c)(3) to be organized and operated exclusively for exempt purposes. Your defining document, your articles of incorporation, state that your purposes are to "promote financial literacy to highly leveraged consumers" and to "Offer products and services to assist the consumers." This document expressly empowers you to engage in activities which do not in themselves further exempt purposes. Offering products and services is the definition of commerce, thus violating section 501(c)(3)-1(b)(1)(i).

Although you are not yet operating, your description of the way that you intend to operate reflects the language of your articles. The offer of products and services to consumers will comprise most of your activity. By your description, sale and maintenance of debt management plans will be your primary activity. Your president has a background in organizations selling debt management plans. Your description of the people you will seek to employ emphasizes selling skills.

The detailed script that you submitted to show how your employees will interact with callers is entirely designed to sell debt management plans. Your employee mentions qualification for a DMP in the second sentence. The questions he is supposed to ask elicit just enough financial information to determine whether the caller fits your criteria for a DMP. If not, no matter what financial problems that caller has, your employee is instructed to "end the call." Your employees do not assist callers in making a budget, or teach them how to adhere to one. The employee does not discuss any alternative solutions to financial difficulties, nor analyze whether a DMP is appropriate for the caller. The analysis focuses entirely on whether the caller meets your requirements. Once the sale of the DMP is complete, the customer must talk to someone in the "customer relations" department if he has a question.

Eventually, you hope to add additional financial products to the DMP. You stated that you may do credit repair, and will refer clients to other commercial vendors for a referral fee. You describe as a long-term goal providing credit cards to your DMP customers. You have not submitted any information establishing that these other products would be in the best interests of your customers. Because you will earn fees for referring your customers to these vendors, your interest conflicts with that of your debt-inflicted customers.

You have not established that your debt management plan or other activities will be incidental to or integrated into a substantial educational program. Your script shows that you do not intend to conduct education through a counseling process. There is no discussion of the caller's general financial condition, nor of the fundamentals of credit and finance. There is no attempt to discover what the caller knows, and what would be helpful to him in improving his financial situation. You have asserted that you intend to mail educational material to your customers, but you have not submitted any drafts. You asserted that you intend to provide financial education to high schools and colleges, but again have not submitted any materials or detailed plans. Furthermore, you do not describe any intent to hire people with a background in education or counseling or finance who could write or teach such courses.

Therefore, you differ from the organization in CCCS of Alabama, *supra*. The employees of that organization spent approximately 88% of their time counseling individuals and only about 12% on debt management plans. The organization also provided a robust program of public education through speakers, films and publications.

The applicant for exempt status has the burden of proving that it is organized and operated exclusively for exempt purposes. If it applies before it commences activities, Rev. Proc. 90-27 requires that proposed operations be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section. You have failed to provide that level of detail. Among other topics, you could not answer questions about the source of your start-up funding, your office or website. You have not submitted customer agreements, help wanted ad, employee handbooks, advertising for the Internet or print media, or any educational materials. Therefore, you have failed to establish that your activities are part of a substantial educational programs and further educational purposes.

Another possible basis for exempt status is providing needed services to a charitable class. Unlike the organization in Rev. Rul. 69-441, *supra*, you do not restrict your services to low-income people, nor do you provide it without charge. In fact, you reject callers whose monthly income is below the level necessary to pay for a DMP. Therefore, you have not established that your activities will serve charitable purposes.

It also appears that you have the substantial non-exempt purpose of operating as a commercial business. Your primary activity will be sale of a financial product: the DMP. In the future you hope to have additional commercial activity of referring your customers to vendors of other financial services for a fee. The training materials and script that you submitted concentrate entirely on sale of DMPs. Your revenue will come, not from contributions from disinterested parties or organizations, but from fees paid by your customers and the credit card companies who benefit from the DMPs. You intend to purchase the names of people to whom you will attempt to sell a DMP. You have failed to establish that your activities further an exempt purpose and are not merely commercial in nature.

Even if we assume that you will provide some educational materials to your customers, and some public education, the totality of your planned activities show a significant non-exempt commercial purpose not incidental to any educational purpose. See, American Institute for Economic Research, *supra*.

Finally, your small board, consisting of two members who are married to each other presents a risk of private inurement and private benefit. The organization in Rev. Rul. 69-441 was run by boards representing the community and included members of religious organizations, civic groups, labor unions, business groups, and educational institutions. Such independent boards provide oversight to prevent the assets of an exempt organization from being taken or misused by insiders.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS*

and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE (SE;T:EO:RA:T:)

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings and Agreements

Enclosures:
Form 437
Testimony of Commissioner of Internal Revenue