



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TE/GE: EO Examination  
625 Fulton Street, Room 503  
Brooklyn, NY 11201

UIL:501.03-01

Release Number: 200723028  
Release Date: 6/8/07

Date: 7/26/06

Taxpayer Identification Number:

Legend

O = organization  
D = Date

Person to Contact:

Identification Number:

Contact Telephone Number:

LAST DATE FOR FILING A PLEADING  
WITH THE TAX COURT, THE CLAIMS  
COURT, OR THE UNITED STATES  
DISTRICT COURT FOR THE DISTRICT  
COLUMBIA:

Dear :

This is a Final Adverse Determination Letter as to O's exempt status under section 501(c)(3) of the Internal Revenue Code.

Recognition of your exemption from Federal Income Tax as an organization described in Internal Revenue Code section 501(c)(3) is retroactively revoked effective D for the following reasons:

You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). You are not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You operate substantially for non-exempt purposes. You are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization.

Please refer to the attached Form 886-A which sets forth the facts, law, and analysis upon which this final adverse determination is based.

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

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

Processing of income tax returns and assessment 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 in court, you must file a pleading seeking a declaratory judgment in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia before the 91<sup>st</sup> day after the date this final determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing pleadings for declaratory judgments and refer to the enclosed Publication 892. You may write to these courts at the following addresses:

United States Tax Court  
400 Second Street, NW  
Washington, D. C. 20217

United States Court of Federal Claims  
717 Madison Place, NW  
Washington, D. C. 20005

United States District Court for the District of Columbia  
333 Constitution Avenue, NW  
Washington, D. C. 20001

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling (718) 488-2080, or writing to:

Internal Revenue Service  
Taxpayer Advocate Services  
10 Metrotech Center  
625 Fulton Street  
Brooklyn, NY 11201

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

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Marsha A. Ramirez  
Director, EO Examinations

Enclosure:  
Form 886-A  
Publication 892

cc: POA

Form 886-A

**ISSUES PRESENTED:**

1. Whether O is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3):

a. Whether O is engaged primarily in activities that accomplish an exempt purpose?

b. Whether more than an insubstantial part of O's activities are in furtherance of a non-exempt purpose?

## FACTS

### BACKGROUND

An audit of O was commenced on D1 for the year ended D2.

O was incorporated under the laws of the S of the Not-for-Profit Corporation Law on. In a determination letter dated D4, O was determined to be exempt from Federal income tax as an organization described in IRC section 501(c)(3). It was further determined to be classified as a public charity as described under IRC section 509(a)(2). O was located at A.

In its Articles of Incorporation, O stated its purpose to be:

- (a) To assist needy debtors to improve their finances through educating them as to better means of managing their money and through seeking for them, if appropriate, an extension or other reorganization of their debts.

To have, in furtherance of its not-for-profit corporate purposes, all of the powers conferred upon corporations organized under the Not-for-Profit Corporation Law subject to any limitations thereof contained in this Certificate of Incorporation or in the laws of the S.

Per the Form 990 filed by the organization for the tax year ending D2, the officers were O1, President, O2, Former President & Director, O3, Secretary & Director, O4, Treasurer & Director and Administrator's O5 and O6.

Salaries for the year ended D2 reflected on Form 990, Part V, page 4 were as follows:

O1 (President)	5
O2(Former President and Director)	
O5 (Key Employee)	
O6 (Key Employee)	

The Board of Directors of                    was comprised of only the Officers and Key Employees of the organization.

### STATUS

The agent was informed after various contacts with the President of the organization and its accountant that the organization had ceased operations at the end of 2003 and had stopped accepting new clients. The organization's place of business has been closed since

2003. The organization has indicated in their responses to certain Information Document Request items that some of the requested records were placed in storage and are not readily available.

Form 990 returns were filed for the years ended D2 and D5. Operating losses were reported on both returns.

The organization's Representative provided a copy of a Servicing Agreement (Exhibit B) which indicated that effective as of D6, [redacted] had assigned to E, an S2 based sec. 501(c)(3) organization, the obligation to provide ongoing credit counseling services to its existing clients. O provided all client files including documentation and information regarding each DMP client to the B. The Servicing Agreement stated that the B, a S3 corporation unaffiliated with E, would simultaneously be terminating its contract with O that had provided payment processing for the clients. B and O had made an arrangement with E to take over the provision of these services.

The Servicing Agreement stated that O assigns to E the obligation to provide the following services to clients, and E accepts such assignment:

- a) Ongoing credit counseling and education;
- b) Processing DMP payments, responding to inquiries from Clients with DMP's and related responsibilities pursuant to an arrangement with Ballenger under an existing Fulfillment Agreement between E and B;
- c) Processing refunds, although O remains responsible for funding such refunds;
- d) Processing regulatory requests with respect to the Clients, although O remains responsible for funding compliance with such regulatory requests to the extent those requirements cannot be satisfied directly by E;

Information Document Request number 10, item 1 requested information as to whether or not Form 990 was filed for the year ended D7 and, if so, requested the date filed or expected filing date. The Representative responded that the [redacted] Form 990 was not filed and the expected filing date is unknown due to the lack of material information needed to complete the return and to current nonpayment of accounting fees.

Information Document Request number 10, item 2 requested information as to when the Final Form 990 is expected to be filed and for what year it will be filed. The organization stated in its response that if a Final return was to be filed, it would probably be for the D7 tax year.

Information Document Request number 10, item 3 asked whether or not a Certificate of Dissolution had been filed with the S and if the Certificate of Dissolution was filed to

provide a copy. The organization responded that the Certificate of Dissolution had not been filed. It hasn't been filed because the attorney is owed several thousand dollars by O for past services.

### NARRATIVE

Information Document Request number 1, item 2c requested a written narrative of the activities of the organization. O responded that it was a non profit credit counseling company that would counsel individuals who were in financial debt. The organization dealt mainly with credit card debt.

O claimed in the response to item 2c that it had trained credit counselors to counsel customers on how to lower their monthly bills by drastically lowering the interest rates on their credit cards. This would help to bring them current with overdue credit card bills. O claimed that they would do this strictly for a voluntary contribution. Customers would fill out paper work, explaining in detail their credit card bills. They would then send the organization their first monthly payment which was supposedly a voluntary contribution.

### NOTES TO FINANCIAL STATEMENTS

Information Document Request number 1, item 3f requested a copy of the audited Financial Statements and Report for the year ended D2. A copy was submitted as requested.

Note A – to the Financial Statements stated the following:

"The Company is a Non-Profit corporation created for the purpose of helping to reduce personal bankruptcy by educating the public about personal money management skills and by assisting needy individuals and families who have financial problems. The principal activities of the Company are providing information to the general public on sound money management, counseling individuals and families who have financial problems and preparing budget plans for those individuals and families who can benefit from them".

### SOURCES OF REVENUE

O's primary source of revenue was Fees which have been incorrectly reflected on Form 990 as gifts, grants and contributions received. There was no breakdown on page 6, Part VII of Form 990 for the revenues received from Creditor Fair Share payments, Client Enrollment fees, Monthly Service fees or Gifts, grants and contributions (if any), Interest, Dividends and other Investment Income (if any), or any other sources of revenue.

A breakdown of revenue was requested in Information Document Request #7, item 4, for the revenues derived from Client Enrollment fees, Monthly Service fees, Creditor Fair Share payments, Contributions, Interest, Dividends and, other Revenue. Per the response, the revenues received for the period ending D2 were as follows:

	D2	Percentage of Total Revenue
Contributions made at time of enrollment	\$	%
Contributions made at time of monthly debt installments		%
Revenues not Classified		%
Total		<u>100.00%</u>

The breakdown of revenue received for the years ended D8 and D9 was as follows:

	D8	Percentage of Total Revenue	D9	Percentage of Total Revenue
Contributions made at time of enrollment	\$	%	\$	%
Contributions made at time of monthly debt installments		%		%
Revenues not classified		%		%
Total		<u>100.00%</u>		<u>100.00%</u>

Based on the response, O's primary sources of revenue were Fees paid by clients at the time of enrollment and Fees paid at the time of monthly installments. These Fees represented 80.38 % of the total revenue generated for the year ended D2. The organization did not separate Fair Share payments from contributions in their response.

Information Document Request #4, item 1 requested information as to whether or not the organization received Fair Share payments from credit card companies and if so to provide a list of all creditors the organization received Fair Share payments from. The organization responded: "Yes, majority of all existing credit cards". The organization did not provide the requested listing.

Information Document Request #4, item 2 requested how the amount/percentage of the Fair Share payment is determined and also to provide all documents which show the Fair Share payment for each of the creditors the organization received Fair Share payments from. The organization responded to item 2 as follows: "Credit Card company makes that decision". The organization did not provide any documents or records listing the Fair Share payments from the creditors.



## FEES

Information Document Request #5, item 6 requested copies of all materials provided to the consumer explaining the fees to be charged for services. The organization responded to item 6 as follows: "Contracts signed by the debtor's explained the voluntary contributions. Some copies of contracts are in storage".

Information Document Request #5, item 11 requested information on initial fees and if they were partially or totally waived and, if so, what percentage were partially waived and what percentage were totally waived. The organization responded to item 11 as follows: "It depends on the member and what they choose to contribute".

Information Document Request #7, item 1, requested details on the fee structure including details on how fees are determined. The organization responded that *Voluntary Contributions* were \$6.00 per month per account and the organization also asked for a *Voluntary Contribution* of 2 percent of their total debt load. Item 2 requested information on the procedures used for clients who declined or refused to pay the fees. The organization responded that the procedures were the same for all clients.

Item 3 requested data on the number of clients who a) did not initially pay any portion of the requested fee for enrollment and, b) did not pay any portion of the requested fee for monthly services. The organization responded "N/A" to item 3.

## LACK OF RECORDS, DOCUMENTATION AND SUBSTANTIATION

As documented above, the organization provided no records, documentation and substantiation for various items which were requested in Information Document Request numbers 1 through 10.

The organization did not provide a list of event presenters or the training each presenter had received as requested in Information Document Request #2, item 2.

The organization did not provide copies of any syllabus, agenda, rosters, sign in sheets, handouts, video or audio tapes as requested in Information Document Request number 2, item 3.

The organization did not provide documents which reflected the Fair Share payment from each of the creditors as requested in Information Document Request number 4, item 2.

The organization did not provide documents, electronic or paper, created when a client was contacted and enrolled in a DMP as requested in Information Document Request number 5, item 16.

The organization did not provide copies of client files maintained for DMP enrollees, as well as, non-DMP enrollees as requested in Information Document Request number 6, item 1. The organization responded: "Some contracts in storage. Non -DMP's were not kept".

The organization did not provide records stating the number of clients who a) Did not initially pay any portion of the requested fee for enrollment and b) Did not pay any portion of the requested fee for monthly services, as requested in Information Document Request number 7, item 3.

The organization did not provide any details as to the certification process of the counselors or the name of the certifying organization as requested in Information Document Request number 8, item 3.

The organization did not provide copies of written counselor evaluations as requested in Information Document Request number 8, item 6.

The organization did not provide copies of any reports on monitoring of counselor's phone calls as requested in Information Document Request number 8, item 7.

The organization did not provide a log of in person interviews and/or counseling sessions the counselors conducted during the year ended D2 as requested in Information Document Request number 8, item 8.

The organization did not provide copies of any scripts and/or job aids utilized by the counselors as requested in Information Document Request number 9, item 1.

The organization did not provide a printout of each of their web site pages as they appeared during the year ending December 31, or in the event the web site was revised the pages of the new version of the web site as requested in Information Document Request number 9, item 5.

The organization did not provide copies of statistical data compiled, maintained or tracked pertaining to the organization's web site as requested in Information Document Request number 9, item 6.

The organization did not provide any reports generated from the web site as requested in Information Document Request number 9, item 8.

## ACTIVITY DESCRIPTION

### DEBT MANAGEMENT PLANS (DMP'S)

The primary activity engaged in by O during the year under examination, based on the additional information submitted, was solicitation of clients to enroll in Debt Management Plans (hereinafter DMPs).

Information Document Request number 5, item 1 requested data on the number of clients that were enrolled in a DMP for the year ended D2. The organization stated that there were        clients enrolled.

Information Document Request number 5, item 8 requested information on the initial telephone call and if there was any discussion of any financial matters other than the potential enrollment of the client in a DMP. The organization responded as follows: "Yes, discussion of whether a DMP might enable them to pay their bills on their own and discussions of credit and how it will be affected and discussions of the contribution".

Information Document Request number 5, item 15 requested information concerning what other counseling is provided in the event that the potential client does not qualify for a DMP. The organization basically stated that they will recommend that the individual call a local attorney for help if they do not qualify or choose to participate in the DMP.

Information Document Request number 5, item 16 requested all documentation, electronic or paper, created when a client is contacted and enrolls in a DMP. The organization responded to item 16 by stating the following: "Some contracts are in storage".

#### **COUNSELOR CERTIFICATION AND EVALUATION**

Information Document Request number 8, item 3 requested information on the certification process of the counselors and asked for a detailed description of the certification process and who the certifying organization is. The organization responded that the counselors have 12 hours of training. They didn't provide any specifics on the training program.

Information Document Request number 8, item 6 requested information on how often the counselors receive written/verbal evaluations of their performance and on what qualities/elements they are evaluated. Information Document Request number 8, item 6 also requested copies of counselor evaluations. The organization responded to item 6 stating that weekly verbal evaluations were given. Copies of counselor evaluations were not provided.

Information Document Request number 8, item 7 requested information on whether or not phone calls were monitored by supervisors and if so requested copies of any monitoring reports prepared by supervisors. The organization's response stated that phone calls were monitored but there are no reports available.

Information Document Request number 8, item 8 requested a log of in person interviews and/or counseling sessions that the counselors conducted for the year ended December 31, 2002. The organization responded "not applicable" to this request.

#### **LACK OF EDUCATIONAL ACTIVITIES AND DOCUMENTATION**

Information Document Request number 2, item 1, asked to identify and explain each of the programs, events and/or activities the organization conducted during the year ended D2 including the relevant details such as the date and location, the number of participants, details of any fees charged, the minimum requirements for client participation, samples of forms, letters and agreements used in connection with these programs, identification of any co-sponsors and the name of the chairperson or members of the organizing committee. The organization responded "not applicable".

Information Document Request number 2, item 2 requested a list of all event presenters and requested the training each presenter had received. The organization responded "not applicable" to this request.

Information Document Request number 2, item 3 requested copies of any syllabus, agenda, rosters, sign in sheets, handouts, videos, or audio tapes distributed during the event and information on whether or not the participants were required to pay for materials during the events, etc. The organization responded "not applicable" to this item.

Information Document Request number 2, item 4 requested a proposed budget reflecting the future funding to be allocated to educational activities. The organization responded that no future seminars will be held as the company is no longer in existence.

Information Document Request number 2, item 5 requested data on a) The number of clients in each of the educational programs at the beginning of the year and b) The number of clients in each of the educational programs at the end of the year. The organization responded "not applicable" to this item.

Information Document Request number 2, item 6 requested to identify each of the programs that had received accreditation, certification or licensing from any Federal or State agency, educational institution, industry association or other organization and provide information on the certifying organization, the date the certification was originally received and the date of the most recent review along with any accreditation letters or reports. The organization responded "none" to this item.

The organization did not provide any substantiation for any programs, events or activities that may have been conducted during the year ended D2.

Information Document Request number 10, item 7 requested copies of pamphlets, brochures, newsletters and other printed literature about the organization. The organization responded "not applicable" to item 7.

#### WEB SITE

Information Document Request number 9, item 3 requested information on the company's web site. Item 3 also requested whether or not education was provided on the web site and who may access this information. The organization responded that education

was provided on the web site and anyone could access it. They provided no documentation of this.

Information Document Request number 9, item 5 requested a printout of each of the web site's pages as they appeared during the year ended D2. Item 5 also requested printouts of the new version of the web site, when it was introduced and the nature of the revision in the event the materials were revised. The organization responded "not applicable" to item 5.

Information Document Request number 9, item 6 requested a list of the statistical data compiled, maintained or tracked pertaining to the web site. The organization responded "not applicable" to item 6.

Information Document Request number 9, item 7 requested information on how frequently web site statistical data is compiled. The organization responded "not applicable" to item 7.

Information Document Request number 9, item 8 requested all reports generated from the web site during the year ended D2. The organization responded "not applicable" to item 8.

We were able to obtain a copy of the home page for O's web site from [www.archive.org](http://www.archive.org) as the organization did not provide any printouts of their web site. This page was dated D8 and is attached. The O web site contained sections for various subject areas including "Who Are We", "Online Services", "Financial Center", "Customer Service", "Get Documents", "Quick Quote", "Your Privacy", "Testimonials", "Loans And You", "Web Search", "FAQs", and "Links". Some of these links had various drop down menus containing sub areas corresponding to the tab. Selecting a certain subject area often provided a choice of sub areas, however clicking on one of these sub areas or major sections did not allow this user to access any information. We were only able to view the home page of the web site.

The home page contained a section "What We Do" and listed the following: "Reduce your monthly payment by almost 50%", "Reduce your interest rate as low as 0%", "Stop creditors harassing phone calls", "Re-age past due accounts to improve credit rating", and "Late fees and over the limit charges will be waived when you're on the program". There were no sections containing educational information on the web site's home page.

#### LAW

Section 6001 of the Internal Revenue Code states that, "Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the

Secretary deems sufficient to show whether or not such person is liable for tax under this title”.

Section 6033(a) of the Internal Revenue Code states in part that “...every organization exempt from taxation under 501(a)...shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the secretary may from time to time prescribe....”

Regulation 1.6001-1 requires an exempt organization to keep permanent books and records sufficient to show specific items of gross income, receipts and disbursements and to substantiate the information required by Internal Revenue Code section 6033.

Regulation 1.6001-1 discusses retention of records and states the following “The books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law “.

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

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). In other words, the two components of education are public education and individual training.

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

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

Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3). 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 purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant nonexempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

The Service has issued two rulings holding credit counseling organizations to be tax exempt. Rev. Rul. 65-299, 1965-2 C.B. 165, granted exemption to a 501(c)(4) organization whose purpose was to assist families and individuals with financial

problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been 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 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 a typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the general public. Its only source of income was from fees for 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.

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

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R. 2<sup>nd</sup> 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. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were "an integral part" of the agencies' counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt

management and creditor intercession activities as incidental to the agencies' principal functions, as only approximately 12 percent of the counselors' time was applied to debt management programs and the charge for the service was "nominal." The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation.

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

The organizations included in the above decision waived the monthly fees when the payments would cause a financial hardship. The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and the 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 counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free



marriage counseling); Rev. Rul. 68-71, 1968-1 C.B. 249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

The 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. 15 U.S.C. § 1679b. Significantly, section 501(c)(3) organizations are excluded from regulation under the CROA.

The CROA defines a credit repair organization as:

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

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

The primary activity of O was not "educational" or "charitable" as defined under the Internal Revenue Code, its Regulations or other legal precedent. The primary activity was the enrollment of debtors in Debt Management Plans. The operations of O were not

consistent with organizations described in section 501(c)(3) of the Internal Revenue Code and its exemption should be revoked.

O was not engaged primarily in activities that accomplish an exempt purpose. The organization operated to serve a substantial non-exempt purpose.

The purpose of O's activities differs substantially from those of the organizations in Rev. Rul. 65-299, Rev. Rul. 69-441, and Consumer Credit Counseling Service of Alabama, Inc. v. U.S. In this case, O engaged in minimal activities which furthered an exempt purpose. The majority of income for the year ended D2 was derived from Enrollment fees, Monthly fees and Fair Share revenue. All of these fees were generated from the operation of the Debt Management Program (DMP).

The organization did not provide records, documentation and substantiation for various items which were requested in Information Document Requests and lacked specific books and records to substantiate many of the activities it claimed to perform including counseling and education.

During the year under examination the organization provided no records to substantiate their claim that counseling was performed for its clients.

During the year under examination the organization provided no records to substantiate any seminars, classes, outreach or any other educational activities.

Records were not provided with respect to seminars, including outlines/syllabus, rosters of attendees, sign in sheets of participants or any other related documentation.

Regulation 1.6001-1 dealing with retention of records states the following "The books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law".

There is no evidence to substantiate that the primary activity of the organization was education and outreach, when the primary activities were placing individuals in Debt Management Plans. There was no documentation provided to substantiate that any educational counseling or followup was performed by O with their clients.

The educational requirement of section 501(c)(3) was not met during the year under audit as no documentation was furnished to substantiate that any educational activities or events took place. There was also no information provided to substantiate that any educational counseling of individuals took place either in person or on the telephone. No client files were provided.

In addition, O had a substantial non-exempt purpose of selling a product, the Debt Management Plan. O was not furthering any charitable or educational purpose by offering a Debt Management Plan.

### CONCLUSION

In summary, O was not operated exclusively for educational or for any other exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code since its primary activity was the sale of Debt Management Plans (DMP's). O did not engage primarily in activities which accomplish an exempt purpose. More than an insubstantial part of the activities of O were in furtherance of a non-exempt purpose.

The organization did not provide records, documentation and substantiation for various items which were requested in Information Document Requests and lacked specific books and records to substantiate many of the activities it claimed to have performed, especially in the areas of counseling and education.

Section 6033(a) of the Internal Revenue Code, as stated previously, states in part that "...every organization exempt from taxation under 501(a)...shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the secretary may from time to time prescribe..."

Regulation 1.6001-1 requires an exempt organization to keep permanent books and records sufficient to show specific items of gross income, receipts and disbursements and to substantiate the information required by Internal Revenue Code Section 6033.

Regulation 1.6001-1 retention of records states the following "The books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law".

The amount of time devoted to education and outreach activities was very minimal compared to O's primary activity of setting up Debt Management Plans. There was no documentation provided on any counseling activities, educational workshops, seminars, outreach or any other educational programs. O was unable to substantiate any educational or outreach activities it conducted during the year ended D2.

O could not provide copies of any client files for individual's who were enrolled in DMP's. O stated that files were not kept for individuals who were not enrolled in a DMP.

O did not provide copies of any written counselor evaluations or logs of any in person interviews and/or counseling sessions conducted during the year ended D2.

Accordingly, it is determined that O. is not an organization described in section 501(c)(3), and is not exempt from Federal income tax under section 501 of the Internal Revenue Code. The organization should be revoked effective D9.

**Redaction Legend:**

**O = organization**

**D1 = date 1**

**D2 = date 2**

**D3 = date 3**

**D4 = date 4**

**D5 = date 5**

**D6 = date 6**

**D7 = date 7**

**D8 = date 8**

**D9 = date 9**

**A = address**

**O1 = officer 1**

**O2 = officer 2**

**O3 = officer 3**

**O4 = officer 4**

**O5 = officer 5**

**O6 = officer 6**

**S1 = state 1**

**S2 = state 2**

**E = unrelated 501(c)(3) organization**

**B = Limited Liability Corporation**