

**Internal Revenue Service
Appeals**

Department of the Treasury

Address any reply to:

Employer Identification Number:

Form Number:

Person to Contact:

Contact Telephone Number:

Fax Number:

**Last Day to File a Petition with the United
States Tax Court** **SEP 08 2009**

Uniform Issue List

501.03-00

Certified Mail

Dear Taxpayer:

This is our final adverse determination with respect to your exempt status under section 501(a) of the Internal Revenue Code ("Code"). Recognition of your exemption under Code section 501(c)(3) is revoked beginning January 1, 20XX.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to 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 must be filed within 90 days from the date this determination was mailed to you. Contact the Clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

Our adverse determination was made because ***** is not operated exclusively for exempt purposes. Under Treasury Reg. § 1.501(c)(3)-1(d)(1)(ii), an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. ***** operated for the benefit of two for-profit corporations, ***** and *****.

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on form 1120 for any years, which are still open under the statute of limitations. Based on the information you furnished, it appears that returns should be filed beginning with the year ending December 31, 20XX. You should file any returns due for these years or later years with the Internal Revenue Service Center, Cincinnati, OH

45999-0012 (as applicable for 1120). Processing of income tax returns will not be delayed because you have filed a petition for a declaratory judgment under Code section 7428.

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance, or you can contact the nearest Taxpayer Advocate office by calling ***** or writing to Local Taxpayer Advocate, *****. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. 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 IRC section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

Sincerely yours,

/s/
Appeals Team Manager



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

Legend

ORG=Name of organization

EIN=EIN number

Taxpayer Identification Number:

EIN

Form:

Tax Year(s) Ended:

12/31/20XX, 12/31/20XX

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

ORG

Certified Mail - Return Receipt Requested

Dear,

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

if you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,
Marsha A. Ramirez

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Letter 3618 (042002)
Catalog Number 34809E

Explanation of Items

Schedule No. or Exhibit Form 990

Name of Taxpayer
CC

Year/Period Ended 20XX12, 20XX12

Legend:**AA = State****NN = Name of Individual****AD = Address****NT = News Outlet****CC = Name of organization****RR = Related Organization****DC = Debit/Credit System****UU = Unrelated Organization****X = Amount, XX = Year****ISSUE**

Whether the CC (CC) is organized and operating exclusively for exempt purposes described within Internal Revenue Code section § 501(c)(3) and that no part of the net earnings inure to the benefit of any private shareholder or individual?

EXPLANATION OF FACTS**Application for Recognition of Tax-Exempt Status**

The CC located at AD AA, was incorporated under the laws of the AA as a not for profit corporation on May x, 20XX. The CC was founded by NN; who was listed as the director, president, treasurer, and secretary of the Exempt Organization (EO).

NN, was the registered agent of the EO during the registration process. The directors listed on the articles of incorporation are NN, NN and NN. In its Articles of Incorporation, the CC stated that its purpose is "to operate exclusively for charitable, educational and provision of debt management services as authorized by the Debt Management Services act purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future tax code and consistent therewith."

The CC filed Form 1023 (Application for Recognition of Exemption) with the IRS under penalties of perjury to apply for recognition of tax-exempt status as a 501(c)(3) on March x, 20XX. The application stated that the Organization planned to "..... reduce the economic impact of excessive consumer debt on individuals and families. CC will also educate individuals and families to improve financial literacy. By performing financial counseling, creating a debt retirement plan, and a complete budget, CC will give individuals and families an alternative to bankruptcy....." The application also stated that the organization intends to devote x% of its time

to performing financial counseling, creating debt retirement plans and implementing budget, and the remaining x% to promoting financial literacy through specialized counseling and education programs on consumer credit and related topics. The application mentioned that the EO will contract with a servicing corporation who will perform financial counseling, create a debt retirement plan and assist individuals and families in implementing the budget by collecting funds and disbursing them to creditors in accordance with the schedule.

According to the application, the Organization expected to receive most of its support from fair share payments made by creditors for assistance in retiring the client's debts. They also plan to receive a portion of its financial support from the clients, through nominal service charges to process and implement their retirement plan.

On May x, 20XX; the IRS determination office requested additional information and clarification regarding activities of the EO. The letter specifically requested clarification on contract for services, debt management plan and exempt functions. The president of the EO responded to the information request on a letter dated June x, 20XX. The summary of the information provided are listed below.

".....CC will contract out for computer processing and administrative support. The contract will cover non-counseling functions of managing and administering the assisted debt management plan. The services outsourced will be data processing services, maintenance of creditor and client data bases, banking and bookkeeping services.....

"....CC plans to solicit for data processing and administrative services from both nonprofit and for-profit corporations. CC plans to contract with the provider who can provide the best service at the least cost

The exempt function was described as "....to provide information to the general public through the use of seminars, publications and the internet on the subjects of budgeting, buying practices and the sound uses of consumer credit, interest rates, mortgages etc. CC also plans to provide counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. These programs are provided at no charge..."

Response on debt retirement plan:

"..... CC will provide advice as to debt proration and payment. A program of monthly distribution of money to creditors is developed. A nominal \$x monthly fee will be charged when counseled individuals opt to have assistance implementing their budgets. This fee will be waived if it would impose an economic hardship. CC will intercede with creditors when necessary to cause them to agree to accept such monthly payment schedules..."

"..... debt management plan may have additional fees. If clients decide to change the creditors on their plan they are charged \$x to cover the cost of altering the plan once it's been programmed. CC plans to offer automatic withdrawal services directly from client's bank account. If a client's withdrawal is returned (for insufficient funds), CC's bank would charge CC. CC plans to pass the cost on to the client..."

Response regarding how the EO facility will be managed, maintained and financed:

"..... Most of the planned educational activities will be virtual and internet based. Therefore, there is no significant space requirement for CC...."

"..... Currently, NN, Chairman of the Board of directors is donating an office to CC from office space that he owns located at AD, AA. This office will be sufficient size for the foreseeable future. The office space will be managed and maintained by NN. NN will not be charging for the use of the office. If and when CC outgrows the donated office space, CC will seek office space elsewhere on the open market

In a determination letter dated July x, 20XX, the CC was determined to be exempt from federal income tax as an organization described in IRC Section 501(c)(3) reasonably expected to be a publicly supported organization described in section 509(a)(2).

Board of Directors, Officers and Key Staff

The Board of directors consisted of NN; President of organization, NN; Director and NN; Director. The organization makes use of volunteers for answering telephone calls and general administration of the organization. The volunteers include, NN, NN and all employees of RR. RR is the back office company responsible for processing DMP plans for various organizations.

NN is the daughter of NN (President of EO). NN is NN's wife and NN's daughter-in-law. NN is NN's mother. NN and NN work for RR. NN is also a co-owner of RR. RR occupy a suite in the building owned by NN (President of EO). The CC operates in the same space used by RR. CC and RR share the rental space, office supplies, phone, and utilities e.t.c.

NN is the president/owner of RR (NN). RR is the law firm that owns some of the DMP plans. RR remits fair share payments received for clients on DMP plans to CC. NN is a long time family friend of NN.

Sources of Income

We gathered from the examination that your main source of income come from a "fair-share" program with RR. CC collects fair share payments from creditors and from RR (RR). Some of the credit card companies pay the fair share amounts directly to CC while some pay the fair share to RR and RR remits the fair share payment to CC at the end of the month. Major percentages of the fair share revenues are collected through RR (RR). This fair share revenue was classified under program services revenue and represents over x% of the organizations revenue. The remaining x% came from investment income. You did not provide a signed agreement with RR (RR) or any of the credit card companies. You indicated that there are no agreements between the parties. You receive no support from contributions from the general public, government or private foundation grants.

Federal Returns

The CC filed Form 990EZ for 20XX and Form 990 for 20XX. Part III (Statement of Program Service accomplishments) of Form 990EZ in 20XX and Form 990 in 20XX described exempt purpose as simply "Debt Management Provider", and their achievement as "promote financial literacy to the general public" . Part VIII (Relationship of activities to the accomplishment of exempt purpose) of the 20XX Form 990 described accomplishment as "Fair share help payments promote the organization's goal of educating the general public on how to manage debt"

According to its 20XX Form 990EZ, CC received \$x from fair share payments which was reported under Program Services Revenue, and \$x from investment income. Total revenue

received in 20XX was \$x. The 20XX Form 990 return reported \$x from fair share payment, and \$x from investment income. Total revenue received in 20XX was \$x.

At the beginning of 20XX, the organization had \$x reported as net assets. This amount decreased to \$x at the end of the year. The Organization's 20XX Form 990 Part IV line 73 reports that as of December x, 20XX, CC's net assets or fund balance was \$x.

Credit Counseling Activity Description

According to the officers and volunteers of the CC, CC was created as the financial education partner of RR (PR); a for-profit company. This relationship was described in a fax sent to the service on May x, 20X as "CC is the financial education partner of NN. NN is an attorney-sponsored for profit debt management provider, which also provides legal services to its clients" The idea, was for CC to educational RR clients on how to maintain good credit, manage debts responsibly and also to mail educational materials regarding debt management to RR clients.

The examination of the current year activity of the EO is slightly different from what was described above. CC has two major primary activity and other incidental activities. The two major activities are described below:

Activity I – Education:

CC engages in educational programs that educate the public about credit card issues and financial responsibilities. CC provides a live call in television presentation on NT(NT – AA), whereby clients or prospective clients call with questions regarding their credits, obligations, and all related personal financial issues. The television program is called "NT" and is televised two quarters during the season. Guest volunteers that are experts in financial education appear on the program to answer various questions or to discuss a particular issue or topic selected for the session.

Part of the education program is also to mail financial management materials to RR clients. However, no evidence was provided to confirm that the organization made "free" distributions of these materials to clients or the general public. But, the officers claimed that this activity was conducted.

They provide over-the-phone counseling to call in clients, if requested. They organize educational presentation to organizations that request such presentations/seminars on a particular topic. No evidence was provided to support the fact that these presentations took place during the year, but the officers verbally confirmed that this activity took place.

CC operates with one paid full-time employee, one paid part-time employee and about five volunteers. The volunteers are all employees of RR, a related for-profit company

Activity II – Marketing:

The CC promotes debt management plans (DMP) for RR (RR). CC do not operate DMP plans nor do they have DMP clients. A DMP is a plan whereby a client makes monthly payments to an agent to satisfy his/her unsecured debts over a x-x year period. Most of the debts handled in a DMP were credit card debts, but other unsecured

debts were also included in some DMPs. CC does not have DMP clients, but they solicit clients for RR during the NT presentation by referring clients to the for-profit company. They also solicit clients during phone calls into CC. CC uses the phone number x. The same phone number is used by RR on some of their marketing materials and publications. Therefore, when you call CC through x, you are indirectly calling RR. When the call is received, the operator transfers you to RR a staff who tries to enroll you in a DMP plan.

What does CC receive from this arrangement? CC receive a fair share payment from RR every month. RR receives payments from debtors, deduct service fees, deducts credit card payments and remits agreed fair share payment to CC. In some other instances, CC receive the fair share payment directly from the credit card company. CC operated as a call center whose purpose was to enroll clients in debt management plans.

Relationship with RR (RR).

RR is an attorney based for-profit debt management plan provider, indirectly affiliated to CC. This company processes debt management plans, collects fair share payments and remits the fair share to RR. CC, during routine television presentations, refers client to RR for debt management plan. However, when they refer the clients, they refer to RR as if it is the same company as CC. The producer will say, "Please call our office at the number on the screen x, and somebody will help you with setting up a debt management plan". They never mention RR when the referral was made. Investigation of the number indicated that the calls were filtered through to RR; which is the company working on behalf of RR.

CC receives fair share payments for the client base of RR to the extent that creditors participate in fair share. CC also pays for the electronic processing of payments for RR clients through UU.

NN worked as an attorney for NN (President of RR) for x years and functioned as one of the attorneys for the RR Programs. NN (President of RR) is a long time family friend of the NN and he used to occupy an office apartment in one of the suites owned by NN (CC President).

Relationship with RR, Inc (RR).

RR is managed by NN, CC president's daughter. The organization is also referred to as "RR". The company is responsible for processing debt management plans, client intake, and overall administration of debt payment plans. This company resembles a back office that processes the transactions for other organizations. They process debt management plans for RR (RR), UU (UU) and others. RR and CC share the same office, phone system, supplies, printers, and utilities. RR employees answer phones for RR, which includes calls made to the CC. The RR employees handle the calls as volunteers, to the extent that they are available.

The space occupied by CC is not easily determinable due to the structure of RR office. RR employees occupy x% of the office. Two volunteers of CC; NN and NN occupy two spaces in the office. However, they work x% for RR.

CC operates mostly outside of the office. The television broadcast (NT) operates out of NT station. Other activities take place outside of RR office. RR receives very few calls from clients of CC. In fact, most of the calls received have to do with debt management plans and not direct counseling.

RR pays x% of the rent , while CC pays x% of the condo assessment fee. The percentage was not based on usage or defined allocation method.

Relationship with UU.

Funds received on behalf of clients as DMP payments are sent to creditors on behalf of the client through a special system used to make electronic payments nationwide. The two systems are; DC and DC. Some creditors accept DC while others accept DC. Individual credit counseling companies cannot link directly to either of the two systems, they usually go through a consolidator. UU was selected by RR as payment consolidator for electronic processing of clients payments. Electronic files containing client information and payments are sent to UU from RR. UU then forwards files to either DC or DC as required. UU debits the money from RR account at MB financial and forwards the Money to DC or DC depending on the creditor.

The Client's information and payments information processed by UU are for the clients of RR, not CC. CC does not process debt management plans.

CC is responsible for paying UU bills based on a contract agreement entered into between UU and CC and signed by CC president; NN on November x5, 20XX. Item 3 of the agreement stated in part, that " ...UU shall have the following duties.

- a. UU shall confirm receipt of electronic files.
- b. UU shall debit funds from Company's Account for Financial files utilizing the Automated Clearing House ("ACH") Network and credit.....
- c. UU will process EDI files on day of receipt

The "company account" mentioned above refers to RR's account.

CC Clients

CC clients consist of all customers on DMP plans administered by RR. Referrals from UU, UU, UU and other organizations involved in debt management services. Clients also include people who call into the NT broadcasts and were referred during the show to call for further help.

Example of Operations

CC operated as follows: when a client called, based on television broadcast referrals or other referral methods, the employee would attempt to enroll the potential client in a DMP. The employee would ask the person for information regarding income and expenses, and what current unsecured debt that individual had. The employee would then prepare a "Client Information Worksheet" which contains name, address, etc, a list of all debts to be covered by the plan, and a "budget worksheet." At this point no counseling or educative information is provided to the caller. The organization is acting and soliciting to enroll the caller into RR DMP plan.

This is evident from transcript of customer service calls listened to during the examination and telephone conversation between RR staff and an IRS agent as described below.:

a) The callers are usually referred from other organizations, and the clients are looking to enroll in debt management plans. There is usually no extensive counseling provided. Minimal Counseling is usually provided when the caller is not a good candidate for debt management plans. At most times, they are referred to other organizations for other programs that might meet their debt need. For instance, if a client is unable to make payment at all, they will be referred to UU (UU), where the client will pay \$x/month for attorney representation to avoid or prevent constant calls from the creditors. In other situations, the client may be asked to print free credit report from online.

b) Due to the same number being shared by RR and CC, I asked a revenue agent to make an anonymous call to CC phone number, to verify their claim during the interview that they provide x% counseling for phone clients. The phone was answered by RR staff. He did not talk about any counseling or seek information on how or what is being done by the client to help manage the debt. Right away, he tried to enroll the agent in DMP program. He indicated that the fee is \$x per month for a maximum of x creditors.

The trend observed during the phone conversations is that most of the callers called to set up debt management plans. In fact, I did not hear anyone call for routine counseling or advice regarding debt problems. On few occasions they provided counseling, only when debt management plan is not an option.

Parties that benefited from CC Credit Counseling Program

RR benefited from this arrangement by having some of their expenses paid for by CC. CC paid the condominium assessment fees; they shared the cost of utilities such as phone, electricity, gas; and also shared in the salary of one RR employee.

RR benefited from this arrangement by increased client base due to NT education programs and having a non-profit agency as a front for the law firm. RR also benefited by shifting the cost of electronic processing to CC.

APPLICABLE LAW

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-1(d)(2), Income Tax Regulations. The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3).

Section 1.501(c)(3)-1(a)(1) of the 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. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the court held that an organization was not organized and operated exclusively for charitable purposes. The court reasoned that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of exempt purposes.

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.

The facts in this case show that CC activities serve to promote the private business interests of the for-profit company, rather than to promote the public interest. The relationship and interactions with for-profit allows the for-profit to perform all services related to debt management program, and then solicit and distribute "fair shares payments" from creditors to CC. In effect, the for-profit benefited by allocating expenses that would have ordinarily been paid by for-profit to CC. Associations with a for-profit organization that benefit the for-profit company constitute an inurement which is a violation of section 501(c)(3).

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 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

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 purposes, 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.

Education provided by CC is totally different from description under Section 1.501(c)(3)-1(d)(3). CC do not provide individual counseling sessions to clients. Observation during telephone calls, disclosed that the focus of the calls are to enroll in debt management plans, not credit counseling. Counseling is provided in few cases, where the client did not qualify for debt management plan. CC claimed to have engaged in educational outreach activity to various community groups. However, there was no evidence to support the claim that much of the activity had actually taken place or that the group presentations did anything other than market the DMP product, if they happened at all. The minimal amount of education activity that was verified involved nothing more than the NT presentations and few minutes of counseling to few people who do not qualify for DMP plans. Majority of the calls are from clients referred from other for-profit companies with the main purpose of enrolling in debt management plans.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

An organization must establish that it serves a public rather than a private interest and "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." Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Prohibited private interests include those of **unrelated third parties** as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the "est" body of knowledge, publications, and methods, the for-profit entity exerted considerable

control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations."

Rev. Rul. 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable for purposes of section 501(c)(3) of the Code. "Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable."

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.

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.

Contrary to the organization described in Rev. Rul. 69-441, CC do not have the same educational substance and content. They do not provide individual counseling regarding money management, or financial counseling geared towards low income individuals to relief the poor and distressed. In addition, while the organization described in the revenue ruling's gross receipts are voluntary contributions, from the creditors participating in the organization's budget plans, CC was supported primarily by "fair share payments" received from creditors. They did not receive any contributions from the public during the periods examined. Whereas, the organization described in the revenue ruling's services are provided without charge to the debtor, the for-profit organization involved with CC, charge a monthly fee for debt management plans.

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. 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 Counselina 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 Counselina Centers of Alabama, Inc. v. United States, discussed immediately above.

The organizations included in the above decision waived the monthly fees when the payments would work a financial hardship. The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way.

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 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.

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." The words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. § 1.501(a)-1(c). The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity" United Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 1999). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

St. David's Health Care System v. United States f 2003-2 USTC 1150,7131, 349 F.3d 232 (5th Cir. 2003), held that a factual issue existed whether a nonprofit hospital was operated for substantial non-exempt purposes through its participation in a partnership with a for-profit organization. The court reasoned that when a non-profit organization forms a partnership with a for-profit entity, the

non-profit should lose its tax-exempt status if it cedes control to the for-profit entity (citing Redlands and Rev. Rul. 98-15).

Revenue Ruling 98-15, I.R.B. 1998-12, 6, (Mar. 04, 1998) several for-profit est organizations exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in §501(c)(3).

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.

Effective date of revocation

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. 51.501(a)-1(a)(2); Rev. Proc. 2003-4, §14.01 (cross-referencing §13.01 et seq.), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in

supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, 513.02, 1990-1 C.B. 514.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01 (crossreferencing § 13.01 et seq.).

GOVERNMENT'S POSITION:

Education is recognized as an exempt purpose by Section 501(c)(3). However, it was determined that CC engages in minimal education activities which further an exempt purpose.

One measure of the relative importance of exempt purpose is the amount of time spent on the activity. The examination disclosed that you have spent an insubstantial length of time on education. The NT presentation is performed every other quarter for average of x minutes per presentation. This translated to, less than x hours per month is devoted to counseling out of x work hours available in a month. In total, for the whole year, you devoted only x hour per annum to counseling out of x available hours. This accounted for less than x% of time spent on education activity as opposed to x% time on education/counseling proposed on the application. An organization that is actively involved in education activity will be expected to spend a substantial percentage of time on education/counseling to provide needed awareness in debt management and counseling to the public.

No meaningful education or counseling could take place in such a time frame on television or on a telephone call. There was no structure set up to allow potential clients to have a face to face meeting with employee/volunteers for the purpose of credit counseling. The customer service telephone conversations did not show that routine counseling is provided over the phone. Majority of the calls are for setting up debt management plans. Unlike the credit counseling organizations described in the Revenue Rulings 65-299, and in Consumer Credit Counseling Service of Alabama, Inc. v. U.S., CC provides no substantial counseling or education to its clients. CC claimed to have engaged in educational outreach activity to various community groups. However, there was no evidence to support the claim that much of the activity had actually taken place or did anything other than market the DMP product. The minimal amount of activity that was verified involved nothing more than the NT presentations and a few minutes of counseling to few people who do not qualify for DMP plans.

You indicated during initial interview that CC provide education and counseling to clients of RR, but there was no evidence that validate your claim. After clients are set up on the DMP plans, there are no follow-up calls or monitoring or counseling the clients to ensure that they understand why they got into debt and how to manage their resources to get out of debt timely to avoid monthly fees charged by RR. During the interview, we asked about how the clients are monitored when they on DMP plans, you answered that"We send them a welcome letter and information requests, monthly statements, and we communicate when issues arise with

accounts....". Response to this question confirmed the fact that clients on DMP plans are not regularly counseled, but are provided minimal services required to maintain their accounts, like a for-profit business will operate.

Your response on a fax dated May x, 20XX stated that " CC provides education materials to clients of NN" to educate them on debt management. There were no records of any monthly newsletter or educational materials sent to clients during the period under examination. Although, financial education books were purchased during 20XX, and you indicated that the materials was meant to be sold to debt management clients, there was no record on how the books were distributed or who the books were distributed to, or if you received payment for them or if they are free. Counseling and education was constantly mentioned as the main function of the EO, but there was no proof of performances in that respect.

The examination revealed that the organization spent only x% of total expense in 20XX and x% of total expense in 20XX on direct education activities. All other expenses relates to allocations and charges from RR company and UU such as salaries of RR employee, rent, telephone and payment to RR for electronic processing of RR client information. Occupancy expense is high and does not reflect accurate usage, but transfer of expenses to you from the for-profit company. It was determined that revenue from "fair share" received from RR, is used primarily to cover operating expenses. Like any ordinary commercial business, your expenditures are exclusively to pay salaries, office expenses, and processing costs to your for-profit service provider; UU. There was no indication that you plan to dedicate any specific revenue to activities involving educational and/or charitable programs. As evidenced in your financial information, you have made no substantial expenditures related to educational activities or programs that would indicate a substantial commitment to this particular activity.

The balance sheet also shows the cash, savings & investment balance as \$x in 20XX and \$x in 20XX. You have the financial means and are equipped to provide debt management education and counseling . However, you kept accumulating funds in your investment accounts while your activities provide substantial secondary benefits to the network of for-profit companies with which you are connected. We do believe that some of your activities would fall within the definition of education. However, your educational purpose is subordinate to your purpose of benefiting the network of for-profit companies with which you are having a business relationship.

The application also stated that the "organization will contract with a servicing corporation who will perform financial counseling, create a debt retirement plan and assist individuals and families in implementing the budget by collecting funds and disbursing them to creditors in accordance with the schedule....."

With respect to actual contract with a service corporation; you allow CC to pay UU for services rendered to RR client. Since CC do not have any debt management plans, or debt management clients, they should not have any payment relationship with UU. Any association with for-profit companies which do not benefit the non-profit organization is not an exempt purpose.

The relationship between the officers, volunteers and key employees shows that all the people involved with the exempt organization are friends, family members, former employees, and current

staff e.t.c. Therefore for-profit companies and not-for profit companies are operating together in a manner that benefit the for-profit company rather than the general public. Associations with a for-profit organization that benefit the for-profit company constitute an inurement which is a violation of section 501(c)(3).

With regard to the staff of RR classified as "volunteers" of CC, they were recruited primarily to serve the interest of their employer; RR. Your telephone "counseling" sessions are primarily dedicated to carrying-out your role as intake-administrator and facilitator to clients before they enroll in a DMP. Thus, it would appear that your employees' primary duty and responsibility consists of marketing DMPs to as many clients as possible, rather than the provision of one-on-one "counseling" sessions or the provision of education to the general public on credit issues. If they counsel callers not to enroll in debt management plans, they are not pursuing the interest of their employers and thus not protecting their jobs. Thus there is a conflict of interest here, which is disadvantageous to the not-for-profit company which is created to help people avoid fees and get out of debt.

The reason why CC was created and operated in this manner is to avoid the regulatory scheme of the Credit Repair Organizations Act (CROA), 15 U.S.C. section 1679,et.seq. CC could not collect "fair share" payments from creditors if it did not have exempt status. RR manage the DMP business, but because they are not exempt, they cannot collect "fair share". Therefore, it serves the best interest of RR and RR to create CC, to collect "fair share payments" and use this money to pay for expenses that relates to DMP plans. This means they transfer for-profit company expenses to CC, in disguise of using CC for education purposes. CC existed for a substantial nonexempt purpose of creating business for RR and RR. Thus, CC's operations resulted in a substantial private benefit to CC's insiders. This is why the NT broadcast gives out CC phone number during the show, but when the callers call in, they call into the RR, and RR staffs answered the call and attempt to enroll the caller in debt management plans.

A §501(c)(3) organization may enter into a management contract with a private party giving that party authority to conduct activities on behalf of the organization and direct the use of the organization's assets provided that the organization retains ultimate authority over the assets and activities being managed and the terms and conditions of the contract are reasonable, including reasonable compensation and a reasonable term. However, if a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be organized and operated exclusively for exempt purposes. See §1.501(c)(3)-1(c)(1); and §1.501(c)(3)-1(d)(1)(ii) .

You also provide substantial private benefit to the credit card companies. In the absence of any charitable or meaningful educational activities you are operating as a collection agency for these companies. The "fair share" paid by the credit card companies would undoubtedly result in significant savings over the possible costs of not recovering any of the unpaid debt owed them. Thus, these companies clearly realize substantial financial benefits through their business relationship with you. It does not matter whether your business relationship between RR and RR are reasonable or excessive, but whether the affiliated for-profit benefits from the operation of the exempt organization.

An organization's purposes may be inferred from its operations. The structure of CC is completely different from what was described in the application process as explained in the fact section. CC operates in a manner indistinguishable and mixed up with a commercial enterprise. It appears that CC's primary goal is to maximize the benefits of the insiders from this arrangement, by portraying the fact that customers are dealing with a not-for-profit company rather than for-profit company.

The prohibition on inurement in § 501(c)(3) is absolute. The Service has the authority to revoke an organization's exempt status for inurement regardless of the amount of inurement. Based on the foregoing, CC has not operated exclusively for exempt purposes under § 501(c)(3).

CONCLUSION:

In summary, CC was not operated exclusively for exempt purposes, because it did not engage primarily in activities that accomplish an exempt purpose, more than an insubstantial part of CC's activities are in furtherance of a non-exempt purpose, CC was operated for the purpose of serving a private benefit rather than public interests, and a part of the net earnings of CC inured to the benefit of a private shareholder or individual. Accordingly, it is determined that CC is not an organization described in section 501(c)(3), and is not exempt from income tax under section 501. It is proposed that revocation of exempt status be effective from January x, 20XX.

TAXPAYER'S POSITION:

The issue was discussed with the representative, but taxpayer's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. Taxpayer will be allowed x days to respond to the conclusion of the examination.