

**Internal Revenue Service**  
TEGE Appeals Programs  
300 N. Los Angeles Street  
Los Angeles, CA 90012

**Department of the Treasury**  
**CERTIFIED**

Release Number: **201005060**  
Release Date: 2/5/10  
Date: 11/9/09  
UIL Code: 501.00-00  
501.33-00

**Taxpayer Identification Number:**

**Person to Contact:**

Employee ID Number:

Tel:

Fax:

**Refer Reply to:**

AP:LA:EMW

**In Re:**

Exempt status

**Tax Years:** 2002 and subsequent  
years

Last Day to File a Petition with the  
United States Tax Court: **FEB 08 2010**

Dear

This is a final adverse determination as to your exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code effective January 1, 2002. Our adverse determination was made for the following reason(s):

You are not operated exclusively for charitable, educational, or other exempt purposes as required by section 501(c)(3) of the Internal Revenue Code. You did not engage primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1). More than an insubstantial part of your activities were in furtherance of a non-exempt purpose. You also operated for the benefit of private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown above.

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 Claims, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> (ninety-first) day after 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 form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.


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.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or 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 final adverse determination of your exempt status, as required by Code section 6104(c).

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

Sincerely,



Karen A. Skinder  
Appeals Team Manager

cc:



DEPARTMENT OF THE TREASURY

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Legend

ORG= Name of organization

NN= Name of individual

EIN= EIN of organization

Date: :

> ORG

Taxpayer Identification Number:

EIN

Form:

Tax Year(s) Ended:

December x, 200X

Person to Contact: / ID Number:

Contact Number:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

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

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

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

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

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

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,

  
R. C. Johnson,  
Director, EO Examinations

**ENCLOSURES:**

Publication 892

Publication 3498

Report of Examination: Form 4621, Form 886-A, Form 6018

**Cc:**

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>	Schedule or Exhibit No.
<b>Name of Taxpayer:</b> ORG	<b>Tax Year(s) Ended:</b> December x, 200X	

Legend

ORG= Name of organization

TM=Training Manual

RR= Related organization

EM= Email

RR2=Related organization #2

MT= Material brochures

NN= Name of individual

x= Amount

ST= State

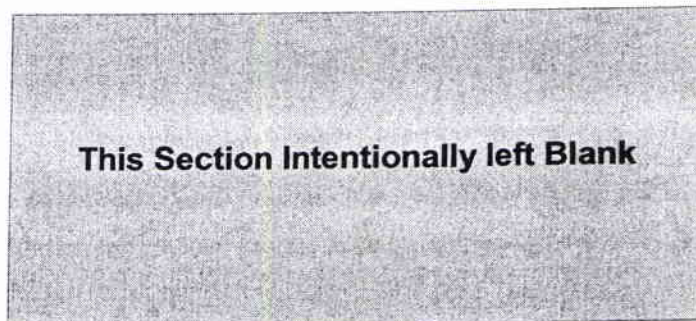
X= Year

CM= Commercial

**ISSUES**

Whether ORG (ORG) is operated exclusively for exempt purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code if:

- a. It is engaged primarily in activities that accomplish, more than insubstantially, a nonexempt purpose and;
- b. Its operations confer, more than incidentally, a private benefit to selected individuals rather than for the benefit of the public's interest?



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**FACTS:**

BACKGROUND

An audit of ORG (hereinafter ORG) was conducted for the tax year ending December x, 200X.

ORG was incorporated under the laws of the ST as a non-stock, nonprofit corporation on or about November x, 199X. No amendments to the Articles of Incorporation have been evidenced. The Articles state that the business to be operated is a "nonprofit debt counseling agency, assisting low-income individuals and families who have financial problems, and educating the public on personal money management." Directors of ORG are to serve one-year terms and may succeed themselves. The named incorporator was NN.

The initial Board members were:

    NN(hereinafter NN)

    NN (hereinafter SLN), (spouse of NN)

    NN (hereinafter NN), (son of NN)

By-laws were adopted on March x, 199X by NN; SLN; and NN. No amendments to the By-laws have been evidenced.

The statement of purpose stated in Article 3 of the By-laws includes: providing credit counseling to families and individuals in need of assistance as proper recipients of charity and personal money management counseling; providing for the instruction and training of families and individuals for the purpose of improving their capability in dealing with budgetary matters; and providing for the instruction of the public on issues relating to budget and debt management.

The Directors shall manage the "property, affairs and business" of ORG as per Article 4 of the By-laws. The number of Board members is indicated as three. Compensation of Directors is permissible according to §4.8, however, the reasonableness of such compensation is determined by such Board members. The executive director/Chairman of the Board, President and Treasurer are elected by the Board for one year terms. The Board may also elect a vice-president secretary or other official positions it deems necessary. See §5.1



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The President "shall have all general active management of the business of the corporation." The Treasurer will "serve as financial advisor to the Board", manage the "Corporation's revenues and expenses", implement "financial procedures adopted by the President or the Board", keep "accurate, verifiable financial records", cause to be deposited "all money, drafts, and checks" and to disburse "funds and issue checks and drafts". See §5.4.

**APPLICATION FOR RECOGNITION OF TAX EXEMPT STATUS**

A Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code (Application), was filed with the Service on April x, 199X. The application was submitted under the penalties of perjury by NN (hereinafter NN), President. The organization's governing body was shown as: NN - Executive Director, SLN - Director, NN - Director, and NN - President.

In response to Part II, Item 1, of the application ORG stated that its benefits, services, and products were to be "targeted to low income, financially stressed individuals and families who are in need of debt counseling and debt reduction education". More specifically it was indicated that "one monthly payment is received from the family, place it in a trust account and disburse it to numerous creditors in accordance with the prearranged agreement with the family's creditors." (The) "debtor will receive full credit against debts for the amounts paid." "No loaning agreements will be permitted." "The debtors will pay \$x per month fee for the advice and support."

The application also asserted ORG's intention that it "will produce educational material in the form of pamphlets", etc. The educational materials "will consist of handouts, voice cassettes, and as funds permit, video cassettes." "The instructional material will focus on money management techniques to benefit the family, individuals, and the community at large. These materials will be distributed directly to individuals at the offices of ORG and through the mail. The educational materials will also be made "available to small groups or those conducting charitable educational sessions on personal money management/debt reduction". Educational materials will also be made available for outreach programs of other organizations such as the UU.

ORG further indicated in its Application that it "will work with churches and other religious organizations in support of their efforts to assist low income, financially stressed families and individuals."

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The form itemized its prospective income as "The main source of support will be contributions from financial institution creditors and corporate creditors, who are expected to return a small percentage of the debtor's payment" back to ORG. The secondary source of funding will be derived from a monthly fee of up to \$x per month that may be requested from debtors. Another source of revenues is expected to be obtained from the Directors of ORG.

The Application identifies NN, NN, and SLN as all performing personal credit counseling duties.

In Part II, Item 5 of the application it was disclosed that RR (hereinafter RR), was a related entity because Director NN is its President and sole shareholder. The statement described RR as "a marketing company for telemarketing and call center services to hospitals, government agencies and financial institutions." Further information was provided in a letter dated June 6, 1996 from NN, in his response to the Service's request for information about how RR's services differ from those offered by ORG. He stated that RR "is an independent sales company and concentrates on the following three major sales areas:

1. Sales of Call Center services for UU
2. Sales of long distance communications for UU
3. Sales of the Predictive Dialing System built by UU, whose President is NN."

NN also responded to an inquiry regarding ORG' process for determining and setting the compensation of its employees. He indicated that the members of the Board will establish all forms of compensation. They will use the individual's personal skills, work experience and industry norms in their decision making process. He also stated that the Board had chosen not to be compensated until such time as ORG' client base could support a staff. He went on to detail the duties and activities of the President and that the Executive Director, NN, "worked as needed on the coordination of the legal, accounting, bonding, hardware and software, and facility matters related to initial operations." "Additionally, he is providing all of the initial funds to begin operations."

Included with the letter as attachment B were the Board meeting minutes of June x, 199X, in which item x shows that the board made a commitment to annually "..review the compensation of all employees to insure reasonableness."



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These meeting minutes also reported that NN resigned from the Board on May x, 199X and was replaced by NN (NN). NN stated in his resignation letter that he felt his action would be in the best interests of ORG by allaying the concern expressed by the Service about the close control of the NN family over ORG.

Attachment "C" of this same letter provided a sample of a payment plan proposal form to be sent to each of the client's creditors in order to facilitate an agreement for a monthly repayment amount. The form identifies the client along with their account number and current account balance. It also provides other information such as the client's total indebtedness, their total number of creditors and the proposed new payment amount being offered.

In the center section of this form, the creditor is directed as follows:

Check ONE box below indicating the method you prefer for your fair share donation.

Deduct x% from each payment ..... (yes) \_\_\_;

Bill a x% donation    Monthly \_\_\_; Quarterly \_\_\_; Annually \_\_\_

The form does not disclose or otherwise represent to the creditor that the agreement may be entered into without any liability for paying the "fair share" payment.

As part of its processing of the Form 1023, the Service requested additional clarifications about ORG' activities in a letter dated June x, 199X.

NN responded to this request in a letter dated July x, 199X. In it he explained that the proposed educational activities to be conducted included "designing and developing instructional materials for delivery at schools, religious and civic organizations." "We also have contacted several agencies for crisis intervention, and are arranging speaking engagements at local church and civic league seminars which are oriented to money-management techniques." With regard to educational activities he quantified them by stating "a minimum of x% of ORG's time and effort is devoted to educational activities, specifically for educating the public about budget and debt management opportunities through local speaking engagements and prepared handouts."

He further clarified that ORG "defines 'low income' to include any client with less than \$x total gross income on an annual basis." And would be the class of individuals to whom activities would be directed.

Form <b>886-A</b> (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule or Exhibit No.
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His correspondence also included the following business card size advertisement, as a sample of their promotional efforts. However, if any additional information about it was provided at the time, it is no longer associated with this item.

Based upon these as well as the previous answers provided by NN, the Service, granted recognition of tax exempt status under §501(c)(3) with an advance ruling for foundation status of §509(a)(2) by letter dated August x, 199X.

Upon the conclusion of the advance ruling period, ORG submitted the required Form 8734, Support Schedule for Advance Ruling Period, which was signed by NN and dated as March x, 200X. In contrast with the sample creditor agreement submitted in connection with the original Application, which had described the expected "fair share" payments from creditors as "donations", NN classified such payments on the support schedule as gross receipts from related activities. Also as a part of this support package was an attachment that provided details about the contributions from Disqualified persons and the receipt of one (1) Unusual Grant, which was excluded from the computation of Public Support.

In response, the Service issued Letter 1050, Final Determination of Foundation Status, to ORG on June x, 200X granting continued Public Charity status under §509(a)(2).

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**FILED FORMS 990**

The Service's records show that ORG has filed a Form 990 annually for each of the years 199X through 200X and reporting the revenue amounts shown below.

**Income Sources as reported on filed Form 990 Returns**

<u>Income</u>	<u>199X</u>	<u>199X</u>	<u>199X</u>	<u>200X</u>	<u>200X</u>	<u>200X</u>	<u>200X</u>
Contributions (Unrelated to DMP Accounts)	\$ x	\$ x	\$ x	\$ \$ x			
Amounts Paid by Creditors through DMP agreements (Fair Share) Reported on Form 990 as Contributions:	\$ x	\$ x			\$ x	\$ x	\$ x
DMP Clients' Monthly Service Fee Reported on Form 990 as Related Program Services	\$ x	\$ x	\$ x	\$ x	\$ x	\$ x	\$ x
Clients' DMP Set-up Fee Reported on Form 990 as Related Program Services					\$ x	\$ x	
Interest on Investments					\$ x	\$ x	\$ x
Gain/(Loss) on Asset Disposal						\$ x	
<b>Totals</b>	\$ x	\$ x	\$ x	\$ x	\$ x	\$ x	\$ x
Percentage Change from Prior Year		x%	x%	X%	X%	X%	x%

The reported contributions on the Form 990, Information Returns from 199X through 200X were primarily made by NN or RR. However, there is one (1) exception, in 199X ORG received a substantial non-cash gift of a used telephone system valued at \$x from UU, whose President is NN, (hereinafter NN). ORG treated this gift as an unusual grant and excluded it entirely from its support computation. NN would later become the fourth member of ORG' Board of Directors in 200X. Also during this time, ORG grouped all of its revenue derived from DMP activities as program service income related to its exempt function.

Beginning with the 200X Form 990, ORG started reporting the "fair share" payments it received as Public Support Contributions. While at the same time, stating in its narrative response to Part VIII of the Form 990, Relationship of Activities to the Accomplishment of Exempt Purposes, that these payments are "Administrative fees" paid by participating creditors who are included as part of an enrolled debtor's debt management program (hereinafter DMP) for the "Collection services" provided by ORG in facilitating the repayment of the debtor's obligations.

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These payments are a standard practice of the credit industry and are generally paid as a percentage of the approved monthly payment remitted. Also, the rates for making such payments are set individually by each creditor. Therefore, they can vary widely from creditor to creditor. Furthermore, while the majority of financial and department stores, who offer credit services to customers, participate in making "fair share" payments; many smaller businesses such as doctors, dentists, lawyers and hospitals, do not.

**RELATIONSHIP WITH RR**

During the time from ORG' start up in 199X through 199X, NN through RR developed specialized software to manage and facilitate DMP processing. After approval by NN, the sole member of ORG' Board of Directors eligible to vote, ORG entered into an Operating Agreement (Agreement) on February x, 199X with RR, a for-profit company owed by NN, its President. The only record regarding the selection of RR for the provision of both software programming and DMP management services was the retained Board meeting minutes reporting the acceptance of the service proposal. No other records were maintained that would support a determination that the selection of RR from among the unidentified competing bidders was unbiased and that the agreement was negotiated at arms length. The Agreement was executed by NN on behalf of ORG, as the Agency and by NN on behalf of RR, as the Processor.

The terms of the Agreement require ORG to maintain its tax exempt status under IRC §501(c)(3), to operate within the guidelines and standards established by the industry's Associations regardless of membership, to acquire or upgrade all software or equipment deemed necessary by the processor and to immediately turn over all newly established DMP agreements to the processor.

RR is required to manage all systems necessary to timely process and deposit the payments received from enrolled DMP clients; disbursing those funds among the clients' designated creditors; issuing monthly activity statements to clients; maintaining all client information records and performing various other related activities including mailings of DMP participation drop letters to both the client and relevant creditors, missed payment delinquency letters, etc. RR is also to compute and deduct the "fair share" amounts from creditors who authorize them to be netted out of each client's payment and to invoice those that do not. RR is to receive \$x for each active client for whom a payment is disbursed. RR is also permitted to assess and collect a \$x fee from those clients whose payments or direct debited accounts are returned as non-sufficient funds (NSF) or otherwise uncollected.

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ORG has reported the following amounts on its Form 990, Information Return as having been paid to RR for the services it provided in the years shown:

<b>ORG</b>	<u>19 iX</u>	<u>200X</u>	<u>200X</u>	<u>200X</u>	<u>200X</u>
Fees paid to RR for services	\$ x	\$ x	\$ x	\$ x	\$ x

**RELATIONSHIP WITH OTHER ENTITIES PROVIDING CREDIT COUNSELING**

Beginning about 200X, ORG and RR started to establish contractual agreements with various unrelated credit counseling organizations as a way to overcome the cost prohibitive technological barriers to implement and offer a viable DMP program option to their debt burdened clientele. While most of these organizations hold tax exemption status under IRC §501 (c)(3), several do not. Under these arrangements, ORG agrees to adopt and assume responsibility for all new DMP client accounts established by the "partnering" organization's efforts. By the end of 200X, ORG had secured contracts with x credit counseling agencies.

RR's role is to facilitate the transfer of the new client's information from the originating agency into ORG's data records. RR would continue to provide all the services as detailed in the agreement with ORG. RR increased the monthly processing charge to \$x for each DMP account disbursed during the period. This additional \$x fee offset the additional costs of the processing and record keeping required for these "partnered" accounts. Although, for those organizations expected to produce a higher number of DMP clients, this fee was usually reduced to match the lower rate charged to ORG.

After each checkrun to disburse payments to creditors, RR deducts its processing services fee. ORG and the partnering agency then split the remaining revenue pool generated by each client's account. This includes any excess portion of the client's monthly service fee over the processor's fee added to the "fair share" fees resulting from the client's payment. Most frequently, the funds are allocated with x% to the unrelated partner entity and x% for ORG. After x year the split could change to x%/ x% if a designated level of monthly client volume was achieved and maintained. Another variation included paying a one time fee to the referring agency because their expected volume of client development was deemed to be too low. NN executed these agreements as the President of both ORG and RR.



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To promote and market their "Partnering" concept and services, ORG and RR both hired RR2, Inc. (hereinafter RR2). The owner and its sole employee is NN, who is referred to as the Director of Marketing. On January x, 200X, NN provided a written statement explaining that RR2 was chosen to perform this service, because he has personally worked with NN since 198X and felt that his extensive sales and marketing experience would help ORG achieve its goals. Although a formal written contract was never created, NN provided a document he titled "Working Agreement for Partnership Services" in which his understanding of the relationship with RR2 is briefly recounted.

To assist RR2 with the solicitation of prospective organizations, RR2 was provided without cost an office, use of a computer with two e-mailboxes, one for ORG at EM, and a second for RR at EM, all necessary office supplies, postage and the use of other office equipment such as telephone, fax and copier machines. He was paid a x% commission based on the processing fee assessment each month from every agency from whom he obtained a service contract. The General ledger reports that the total commissions paid by ORG to RR2 during 200X amounted to \$ x.

RR2 utilized a marketing document titled "A Partnership for the Future" and distributed it to the credit counseling organizations he solicited for participation. This document emphasizes the industry's need for "Maximizing Fair Share". "Everyone understands the importance of making sure that fair share payments from creditors remain as high as possible." "From the outset, ORG has recognized the responsibility for meeting each and every creditor's requirements in order to secure the maximum fair share available for their partners." This marketing proposal exclusively addresses the business efficiency, profitability and convenience this partnering program provides to organizations seeking an alternative solution for developing a viable DMP program.

RR2 as the marketing director for ORG and RR, generally solicited smaller agencies to partner with ORG and the larger agencies with an existing DMP client base to contract directly with RR for services.

The DMP program collected about \$ x from x clients and then disbursed it to about x creditors on behalf of those consumers.



Form <b>886-A</b> (Rev. January 1994)	<h2 style="margin:0;">EXPLANATION OF ITEMS</h2>	Schedule or Exhibit No.
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ORG' total revenue related to the operation of its DMP program in 200X was

DMP Client Service & Set-up Fees	\$ x	x %
"Fair Share" payments from Creditors	\$ x	X %
<b>TOTAL DMP Revenues</b>	<b>\$ x</b>	<b>X %</b>

As a result of these contractual agreements, the "Partnering Agency's" share of the revenue was \$ x. ORG reported these payouts to each partner agency for their portion of the DMP revenue on its Form 990 of 200X as a Grant issued to provide support for either their credit counseling program or Money management activities and were reported as follows:

<u>Partner Agency</u>	a.) Grants for Credit Counseling	Split	b.) Grants for Money Management	<u>Total Grants</u>
RR	\$ x	x%	\$x	\$x
RR	-		\$x	\$x
RR	-		\$x	\$x
RR	\$ x	x%	\$x	\$x
RR	-		\$x	\$x
RR	\$ x	x%	\$x	\$x
RR	-		\$x	\$x
RR	\$ x	x%	\$x	\$x
RR	-		\$x	\$x
RR	\$ x	x%	\$x	\$x
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RR	\$ x	x%	\$x	\$x
RR	-		\$x	\$x
RR	\$ x	x%	\$x	\$x
RR	-		\$x	\$x
RR	\$ x	x%	\$x	\$x
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RR	-		\$x	\$x
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\*\* Agency is not exempt under IRC 501( c)(3).

\$x

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**ADMINISTRATION**

Beginning in 200X, the minutes of the Board of Directors' meetings revealed the following Board members and officers:

- NN President, Director and Original Incorporator
- SLN Secretary, Director of Education [NN's spouse]
- NN Director
- NN Director
- NN Advisory Committee [NN's spouse]
- NN Advisory Committee [NN's spouse]

The minutes of August x, 200X indicate that NN has been instrumental in changing the monthly administrative fees permitted to be charged in ST from \$x to \$x and detailed a discussion that involved the placing of additional advertising.

There continued to be detailed discussions of the advertising strategy related to the debt management program in the minutes dated July x, 200X.

In the minutes dated May x, 200X NN reports that there were significant declines in "fair share" payments and that where state regulations permit, ORG should begin seeking a \$x fee "to off-set costs of initial creditor fees for RPS requirements and initial bank fees for payment set-up."

NN reported in the minutes dated June x, 200X that new challenges facing the credit counseling industry include: creditor's continued slashing of fair share payments; increased regulations by the states; new fees for investigations; and bad publicity resulting from published Articles by the x.

There were no discussions reported in any of the minutes of the Board's meetings between 200X and 200X regarding educational methods, materials, content or on the future development of such programs.

**ACTIVITIES:**

A script utilized by "Intake employees" (which ORG calls phone counselors") titled "MT" was provided by ORG with a revision date of x/x/200X. (See Exhibit 1) Versions prior to this date could not be located. After the "Intake Employee's" introduction and obtaining some basic contact information about the prospective client, they begin by first advising the caller "I will send you some information after I explain our program."

They then continue with the following statement:

As the information about each debt has been sufficiently collected, the caller is advised of some of the concessions each creditor provides to program participants. After this, the new total monthly payment is presented along with a comparison of their current regular monthly payment and providing a figure representing total savings from being on the plan.

It is at this point that ORG discloses both the set-up fee to be deducted from the initial payment returned by the prospective client along with the completed enrollment forms and the amount that has been included in the new monthly payment that will be deducted each month as a "Donation" for their participation in the DMP program.

The remainder of the script describes ORG' debt management plan's process for eliminating debt and details a few of the benefits the caller will experience through enrollment. The training booklet for "Intake Employees" describes the benefits of credit counseling as:

"... saved thousands of people from bankruptcy and millions of dollars for credit card companies. ...Other benefits include but are not limited to:

- Reduced Monthly Payments.
- Reduced Interest Rates.
- Eliminating Late and Over-the-Limit fees. "

The script does not contain any instructions regarding any required discussion about the caller's circumstances, which led to their indebtedness such as medical illnesses, changes in employment, spending habits, etc.

Nor is there any indication that callers are screened in a way to limit participation to those individuals who are considered "low income", as originally proposed in ORG' application seeking exemption. In response to a request for the general criteria used for determining a caller's eligibility for joining the program, the following list was provided:

Minimum Requirements
a.) At least \$ x of Unsecured Debt
b.) Accounts must have at least a \$ x balance

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While not included in this list, the caller must also satisfy any restrictions imposed by each of their creditors.

A specific length of time that a counselor may spend with a caller has not been set. ORG' phone system records indicate

**200X Duration of ORG Pre-DMP Counseling Calls**

**Inbound Calls**

X	<b>&lt; 1 min.</b>	<b>1~10 min.</b>	<b>10~20 min</b>	<b>20~30 min</b>	<b>Over 30 min.</b>
<b># of Calls</b>	x	x	x	x	x
<b>% of Calls <sup>3</sup></b>	x	x	x	x	x
<b>Cumulative %</b>	x	x	x	x	x

**Outbound Calls**

X	<b>&lt; 1 min.</b>	<b>1~10 min.</b>	<b>10~20 min</b>	<b>20~30 min</b>	<b>Over 30 min.</b>
<b># of Calls</b>	x	x	x	x	x
<b>% of Calls <sup>3</sup></b>	x	x	x	x	x
<b>Cumulative %</b>	x	x	x	x	x

**Total In/Out Bound Calls**

X	<b>&lt; 1 min.</b>	<b>1~10 min.</b>	<b>10~20 min</b>	<b>20~30 min</b>	<b>Over 30 min.</b>
<b># of Calls</b>	x	x	x	x	x
<b>% of Calls <sup>3</sup></b>	x	x	x	x	x
<b>Cumulative %</b>	x	x	x	x	x

This report shows that "Intake Employees" handled x telephone calls in 200X. Of these, x% were inbound calls and on average about x% of all these calls are x minutes or less in length. NN explained that often a caller does not have all the information on hand to complete the enrollment process or needs to discuss the plan with a spouse or are calling from a location from which they were unprepared or unable to discuss matters at length and must call back or schedule a time for an intake employee to call. However, it is not uncommon for a caller to phone in several times before deciding to whether to enroll in the program. It was also noted that the phone system is unable to track the number of calls one (1) individual may make and therefore the count of calls reported does not truly reflect the actual number of people contacted.



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After completing the call, the ORG "Intake employee" mails an information packet for DMP enrollment to each qualified caller, to review and make a decision about enrolling.

The information packet relates entirely to facilitating the establishment of a debt management plan and contains:

The cover letter requests the caller to return the signed Debt Management Agreement, a completed Debt Summary/Information sheet and the Direct Debit Authorization form along with a money order for the estimated first month's payment that was proposed during their telephone call. The letter also advises the potential client that upon returning these completed documents, each of their creditors will then be contacted to advise them of the client's enrollment in the plan and to make a payment proposal. Once the plan has been approved by their creditors, funds will then be promptly disbursed. In addition, participants will begin receiving a statement detailing their monthly transaction activity.

The Debt Management Agreement (*Exhibit 2*) stipulates the DMP Enrollment fee; the monthly debt payment; and the monthly debt management fee. The Debt Management Application requests both personal and financial information from the debtor which is necessary to determine a monthly payment amount and for directing debt payments. The debtor is also asked to check one of four choices to indicate the reason they need to enroll in the debt management program.

Intake employees utilize a specific software package for purposes of inputting and controlling each DMP participant's account data. ORG calls this the "Debt Analysis and Credit Counseling System". This software is leased from RR, the company owned by NN. The system is known as "Intake". The document provided by ORG pertaining to Intake indicates that it is "designed to the [sic] support and automate the debt analysis and sign up process associated with ORG's ". The booklet describing the Intake system states the "Theory of Operation" as follows:

- A phone call is received regarding the ORG debt management plan and the plan is detailed to the caller.
- If the caller is interested, the debt screen is utilized to analyze the caller's current debt situation and calculate the expected savings of participating in the plan.
- If the caller remains interested other information is obtained in order to transmit the application package to the caller.
- Once the completed debt management program forms are received from the caller, the debt information is input into the system and RR begins the physical management of the caller/client.



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ORG also reported that x in-person "counseling" sessions were conducted in their office. In response to the Services request for records of these encounters, ORG stated that the records regarding these meetings were not retained, unless the debtor opted to enroll in the DMP program. Then the completed enrollment forms would have been placed in their client account file. The number of DMP enrollments resulting from in-office meetings could not be determined.

ORG provided the following statistics regarding the success rate of the DMP program:

a) Cancel within X Months	X %
b) Cancel between x-x Months	x%
c) Cancel between x-x Months	X %
d) Cancel after x Months	X %
e) Completed on the Program	X %
f) Completed off the Program	X %

In addition, it was stated that the estimated average completion time is about x (x) years but the actual average is about x years.

### ADVERTISING

ORG primary method of advertising is through the placement of Ads in the phone directories of major markets. Below are some samples of their content and placements:

SuperPages.com in 200X:

Yellow Book in 200X:

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As part of the review of ORG' other promotional activities, three (3) Television commercials were provided on a video cassette in VHS format. NN explained that an airing schedule showing broadcasts during 200X could not be provided because they were run during time periods with unsold advertising air times and that the advertising fees paid were based upon the number of responses generated. While this method permitted frequent airing at greatly reduced rates, the down side was that they were also usually aired during the overnight hours, which has a significantly lower share of viewers.

The first commercial, titled "CM\_" and dated January x, 200X features NN, ORG' President and focuses on how long it takes to pay off credit card debt and illustrates how much can be saved by contacting ORG for help and also states that there are no set-up fees. The presentation has a unique visual style and an urgency for action in its message, to get help right now, it describes the benefits of the DMP program.

The second commercial titled CM also dated January x, 200X is presented in x (x) versions. One is x sec. in length and the other is x sec. long. Each focuses on a woman who appears to be a single mom and is stressed out over her indebtedness and the impact it's having upon her daughter's quality of life. As a solution, the benefits of ORG' program are enumerated as: reducing or eliminating finance charges; rapidly eliminating balances; friendly, caring certified credit counselors are waiting to help and that there are no set-up fees. This ad is quite emotionally charged, while presenting the benefits of enrolling in the program.

### WEBSITE

ORG was requested to produce a print of its website as it appeared in 200X. ORG responded that it does not store archives of web pages or maintain back-up copies of prior versions. A print of the website dated 0x/ x/ 200X was provided by ORG. The website provides information and printable forms to join the DMP program and includes a sample savings calculator, which after you select your creditors name and input your current balance and monthly payment will return a comparison report showing the total amount you will pay off the plan, on the plan and the total savings benefit by being on the plan.

Another section of the website is titled "Credit Counseling". This section provides further details about the DMP process. Nearly all of the information presented is related to DMPs, the exception is a budgeting worksheet available in x (x) versions, one in a short format, the other is longer and more detailed. Both are fillable and can be printed or downloaded to complete while offline. There were not any instructions or guidance provided to assist in their use.

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The site has a feature, begun during 200X, named "E-Counselor" which is an on-line DMP enrollment application. It guides one through all the questions necessary to gather the information needed to make a determination whether a DMP is an option or the user does not qualify. It was accessed x times during 200X. It allows the user to securely save, quit and return at a later time to continue completing their application. There were no reports provided, which state the actual number of individual applications completed, the number of unqualified applicants or the number of applicants who entered into the DMP program..

The website also provides secure access to enrolled DMP participants allowing them to update their personal data, add additional creditors and the ability to view their account transaction history.

**"COUNSELORS"**

ORG stated that the qualifications it considered in making its hiring decisions were the applicant's having some experience in either customer service or dealing with the public. Experience in the any financial services field was preferred. Possessing good communication skills and passing a typing test.

During most of 200X, ORG had x (x) employees. ORG refers to this position as an "Intake Counselor" who works primarily via telephone. The initial training program for new employees lasts for x (x) week. To aid in this process, ORG developed an in house training manual titled "ORG "Intake Counselor Training Manual" that covers such items as the history of ORG, its relevant policies, procedures, computer system use, and communication skills. In addition to these classroom sessions, new employees also spend time on-the-job with an experienced employee. Beginning, by observing; next taking calls with assistance; then progressing finally toward taking calls independently.

The manual describes the "Intake Counselor" position as follows:

*"Communicate to the client the benefits and limits of Credit Counseling. Counsel the client on their financial situation and the alternatives to bankruptcy. Analyze financial status and provide ORG Credit Counseling debt management application to client. Inspect incoming packets. Enter client demographics, budget analysis, and debt information into Follow-up intake."*

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The manual maintains a section titled "In House Hardship Plan". It states that ORG "no longer offers a Hardship program. Clients must be referred to their original creditor for hardship terms." It then goes on to detail that DMIS pricing for several large creditors "can be adjusted as a last resort." It also states that with a supervisor's authorization, the monthly service fee can be adjusted in \$x increments for a period of x (x) months. Classification as a hardship is limited to x (x) months.

A x page booklet that accompanies the manual was also provided. It contains x (x) unit tests and x (x) designated as "Final exam". NN reported that at the end of the first week a quiz is administered. The required minimum grade to pass is x%. Then between the second and third weeks another exam is given and also requires a minimum score of x%.

As a part of the training, they are also introduced to ORG' "Quality Systems Manual, which addresses eight quality objectives, all of which deal with the evaluation and improvement to the organization's management and the processing of the DMP program.

Neither of these manuals contains any topics that discuss ORG' educational goals, methods, materials, content or any future development plans of such programs. In addition to these in-house systems training, Intake employees are expected to obtain their Certification status with-in x months of their date of hire. This is obtained from an independent unaccredited for-profit organization named "UU". (hereinafter UU).

Once training has been completed, the employee's performance appraisal will include Telephone Monitoring (EXHIBIT 3) and an Incentive Evaluation (EXHIBIT 4). These are prepared monthly to rate the employee's effectiveness during their interaction with callers and in accomplishing their other job responsibilities such as correctly performing their "Intake" functions. The inspections of the limited number of both of these forms completed by managers in 200X do not contain any comments or reference to the any issues or topics the employee discussed with callers. Nor do they indicate the final recommendation made to resolve the caller's issues.

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**EDUCATIONAL MATERIALS and OUTREACH ACTIVITIES:**

The Form 990 in Part II, Statement of Functional Expenses, requires the organization to itemize its expenses. The Form for 200X does not report any significant expenditures for either Postage or Printing costs. The Service requested documentation of educational activities such as materials distributed, seminars conducted and any other outreach activities directed at either those individuals utilizing ORG' services or the public at large to aid with improving their management and use of credit. the public with regard to making contact with

The only information provided in this regard was a tri-fold pamphlet titled "" a program organized by UU for the Fall Sessionc1 (Sept. x – Oct x), which "offers a variety of adult equipping courses to provide the experiences, resources and training necessary to progress toward the purposes of God in each of our lives." All of the topics and subjects related directly to religious issues and concepts. NN's five week class was titled "Working for a living or a Giving?".

The course presenters were shown as NN and along with their picture. The caption acknowledges that they are the founders of ORG, which is characterizes as being a ministry.

An attendance sheet was attached showing that at least x (x) people attended at least one class with only four attending all five sessions. The course was accompanied by a x page booklet titled "MT"at was authored by NN and Inside the manual is a short questionnaire, to evaluate the student's financial condition. At the bottom of this worksheet, the course name is printed along with the presenter's surname. The program was neither conducted nor sponsored by ORG.

The text makes a single reference to ORG, (Only the odd numbered pages were provided), in response to a question on page x that asks "What alternatives do I have when I cannot make my payments?" The second suggestion is to obtain a "'debt management plan' with ORG Credit, of course!"

No other information was submitted.



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**LAW:**

Section 501(c)(3) of the Code exempts from federal income tax, corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in any political campaign on behalf of any candidate for public office.

Section 6001 of the Code provides 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.

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).



ORG

December 31, 200.

In Better Business Bureau of Washington D.C.. Inc. v. United States, supra, The Court found that the organization 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.

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 be 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 Internal Revenue 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 the 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."

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Private benefit does not necessarily involve the flow of funds from an exempt organization to a private party. Rev. Rul. 76-206, 1976-1 C.B. 154, considered an organization formed to promote broadcasting of classical music in a particular community. The organization carried on a variety of activities designed to stimulate public interest in the classical music programs of a for-profit radio station, and thereby enable the station to continue broadcasting such music. The activities included soliciting sponsors, soliciting subscriptions to the station's program guide, and distributing pamphlets and bumper stickers encouraging people to listen to the station. The organization's board of directors represented the community at large and did not include any representatives of the for-profit radio station. The revenue ruling concludes that the organization's activities enable the radio station to increase its total revenues and therefore benefit the for-profit radio station in more than an incidental way. Therefore, the organization is serving a private rather than a public interest and does not qualify for exemption.

In International Postgraduate Medical Foundation v. Commissioner, the Tax Court held that the exempt status of a corporation under IRC 501(c)(3) was properly revoked because the corporation was not operated exclusively for exempt purposes. The corporation conducted continuing medical educational tours abroad. The purposes of the corporation consisted of 1) providing benefits to a for-profit travel agency that arranged tours for the corporation's seminars, and 2) providing sightseeing and recreational activities. The corporation was formed by the owner of the travel agency to obtain customers for his business. The owner controlled the corporation and exercised that control to benefit his travel agency.

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 section 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 section 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 services were provided without charge. The organization was supported by

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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 discussed above in Consumer Credit Counseling Centers of Alabama, Inc. v. United States.

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 UU.

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.

In Rev. Rul. 72-369, 1972-2 CB 245 denied exemption to an organization providing managerial and consulting services on a regular basis for a fee is trade or business

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ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code

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). Organizations having exemption under IRC Section 501(c)(3) are not subject to either of these restrictions.



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**DISCUSSION and ANALYSIS:**

In order for an organization to be described in §501(c)(3), it must be organized and operated substantially for applicable purposes thereunder. The presence of a single non-exempt purpose, if substantial, prohibits exemption. The burden of demonstrating continued entitlement to recognition under §501(c)(3) lies with the organization.

Exempt Purpose

The purpose of ORG'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, ORG has engaged in minimal, if any, activities which further an exempt purpose. Section 501(c)(3) does not include the purpose of relieving the dept of individuals who spent too much.

Although called "counselors", ORG's Intake Employees' activities are nothing more than a screening and sales activity seeking participants to enroll in their debt management program. Its "Intake Employees" are essentially telemarketing sales representatives and data entry clerks who have been instructed in a process to facilitate obtaining a potential client's information into their "Intake" software system, a database of DMP customers. While there have been numerous revenue rulings which have determined that providing counseling services may qualify for exemption, ORG has failed to present any validation to support its claim that consumers have been provided sufficient information, gained a knowledge or skills necessary to improve their financial circumstances.

Unlike the organization described in Rev. Rul. 69-441, 1969-2 CB 115 (Jan. 01, 1969) ORG markets and sells DMPs to any consumer who can afford the payments. It has not established any procedures that would limit their services to persons at or below a level of income, which could provide for exemption by aiding the "poor" or another class of individuals, which are generally characterized as being worthy recipients of charity. See Income Tax Regs. §1.501(c)(3)-1(d)(2).

Although, any DMP client who does not include or pays less than the requested monthly service fee "contribution" amount, is not contacted seeking the missing amount, there are no instructions for employees regarding the waiver of fees for persons unable to afford its services. Specifically, the training guide provided to employees indicates that ORG does not have a hardship program. But goes on to state that fees may be reduced in \$5.00 increments for up to three months, with a manager's approval. This type of reduction may be extended once for a maximum of six months and must be necessary to permit the caller to qualify for program enrollment. This is the only reason or example given for a reduction in fees.

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ORG states that it provides substantial counseling and education to consumers because only about x% of callers are placed in a DMP. Their claim that because x% of callers are not enrolled in a DMP indicates they must be getting counseling and educated about their financial situation which results in the caller choosing between alternative solutions to their debt problems. This is completely without any merit. There can not simply be a default conclusion that counseling and/or educational activity must be occurring without any evidence to support such a claim.

See Treas. Reg. § 1.501(c)(3)-1(d)(3).

However, the statistic being cited is a mischaracterization of the facts because ORG data reflects that of the total ~x calls handled in 200X only about ~x did qualify for enrollment which is ~x percent. Of these, nearly ~x actually completed enrollment into the DMP program. This represents about a ~x percent enrollment rate of those who are determined to be eligible.

Although nearly ~x percent of all callers are determined to be unqualified for a DMP, ORG did not collect and therefore was unable to provide any detailed data to show any of the numerous reasons why an individual does not qualify to participate in the Program. Such reasons could be having an insufficient income to support making the payments, unemployment or any source of income to make a payment, creditor terms for participation fail to provide any significant benefit such as interest rate reduction or lower required payments, simply not providing sufficient information or not calling back for a determination to even be made. A second factor could include that some callers need to call more than once. ORG' phone system could not determine how many of the reported total call count were from the same person, which means the total count of actual first time callers would be lower, resulting in a higher percentage of persons qualified for a DMP.

Also about ~x percent of consumers determined to be eligible for DMP participation failed to complete the enrollment process. ORG stated that it did not collect any detailed data regarding the reasons why this group chose not to enroll. Some common reasons people fail to complete any type of transaction could be that they are uncomfortable about sending the enrollment fee before any type of service has been provided, they feel that sending money by wire takes too much additional effort, is too complicated or too expensive. Again ORG chooses the default logic that the consumer was counseled about other choices available to them and chose to pursue one of them. Lacking any evidence to support this conclusion, it becomes meaningless.



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In reviewing all of ORG' employee training materials, advertising, telephone scripts, and employee evaluations, they all attempt to equate "credit counseling" with "DMP program" participation and do not contain any material or information promoting any other alternative solutions.

Employees are not trained to provide in-depth interviews or any skills for recognizing a caller's need for some other type of counseling. Intake employees merely provide some basic financial analysis and basic information about credit policies in order to answer questions posed by the caller while gathering sufficient information to determine a caller's eligibility for a DMP.

The monitoring of employees live in real time phone conversations with consumers and reviewing employee evaluations completed by ORG' management in 200X, found that the primary focus was on analyzing the effectiveness of the employee in determining the consumer's eligibility for a DMP and their efficiency in completing and processing DMP related documents.

The inspection of a sample of DMP client account files and contact records failed to note any references in any employee's comments that was not entirely related to their DMP account.

ORG did not demonstrate that it engaged in any meaningful educational outreach. The one item presented, makes no reference to ORG' involvement or participation, other than mentioning, as part of NN and SLN's biographical statement about their long involvement in the financial services industry and they are ORG' founders,.

Substantial Non-Exempt Purpose

In addition, ORG had a substantial non-exempt purpose of selling a product, the DMP. They benefits of the product are promoted in its print advertising material, Internet web site (EM), which is read as " and even in the employees introductory statement to callers. "ORG . . . has

...". This is not furthering any charitable or educational purpose. Based upon both the prominence and amount of space devoted to enumerating the benefits provided, ORG' advertisements are to primarily promote the availability of its product, the DMP program. Even their television commercials, while quite emotional and very memorable, they all focus entirely on the benefits provided by their product in the same commercial manner as any other business enterprise. In themselves, these ads are not a determining factor. However, when combined with other factors and viewed as part of the overall business activity, the business rather than the educational purpose becomes clear.

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The fact that employees were not instructed on ways to provide each caller with educational materials, information or counseling that was directly related to the caller's circumstances such as developing a budget plan with them or discussing their spending habits during their initial training or as part of a continuing education program for employees is a significant omission for an organization entrusted to educate the public about their financial health. Absent the accomplishment of an exempt activity, the DMP program merely becomes a debt collection activity that constitutes the overwhelming activity being carried on by ORG, which results in it being operated for a substantial non-exempt purpose. See

Better Business Bureau of Washington D.C. Inc. v. United States and American Institute for Economic Research v. United States.

This non-exempt activity is further evidenced by the "Partnering" concept developed and promoted by ORG and RR, using the name ORG. Nearly ~ x percent of the ~x DMP clients in ORG' program were either initiated, transferred or referred by one of their x partner credit counseling agencies. ORG by contractual agreement assimilates these DMP clients into their database and payment processing schedule. ORG states that this allows the partner agency to focus exclusively on providing educational credit counseling services to the public without the need for the investment in any additional technology or the administrative bureaucracy that an in-house DMP program would require.

While this may be true, Rev. Rul. 72-369, supra clearly states that providing a service to non-profit organizations, even at cost, will not qualify for tax exemption under §501(c)(3) of the code.

ORG' hiring of RR2 as the "Marketing Director" is also a reflection of the commercial nature of ORG attempt to exploit a newly discovered and untapped market of small agencies that lack the resources to institute a DMP program. Again, the contracted provider was selected without any other bids or candidates being considered. By providing RR2 the opportunity to earn a limitless commission based on a percentage of the processing revenues generated each month from each client's account for the entire duration of the account's activity is another example of the business intent of ORG.

There were two significant reasons why ORG and other credit counseling agencies have organized as an exempt organization under section 501(c)(3) of the Internal Revenue Code. The first and primary reason is to avoid the regulatory provisions of the Credit Repair Organizations Act (CROA), 15 U.S.C. section 1679, et. Seq. CROA was enacted to protect consumers by banning certain deceptive practices in the credit counseling industry. Had ORG been organized as a for-profit company, CROA would prohibit it from charging fees in advance of fully providing its services. However, as a section 501(c)(3) organizations ORG is exempted from the provisions of CROA.

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This permits ORG to engage in the same deceptive business practices that Congress intended to prohibit when it passed the CROA law. As such, ORG, in failing to operate for exempt purposes, has been unlawfully operating its business while avoiding federal regulations.

The second reason for ORG' obtaining exemption is that without such status it could not otherwise collect "fair share" payments from creditors, who generally require exempt status before making any payments. In 200X ORG derived nearly x of its income from those creditors making such payments.

An additional benefit to exempt charitable organizations that has developed since ORG was originally granted its exemption. ORG is also exempted from the provisions of the FTC's National "Do Not Call" listing and would permit them to solicit consumers for their services through the use of cold call contact.

The entire DMP business depends on an organization enjoying recognition of tax exempt status under §501(c)(3) to avoid several important regulations and restrictions designed to protect consumers.

#### Private Benefit

RR created and copyrighted the DMP Management and Intake System (hereinafter DMIS), a computer software program by utilizing NN's position as ORG's controlling operating officer in two ways. First, RR was given access to the insider knowledge of the Credit Counseling industry gained by NN from his duties and experiences with both ORG and as a member of the Board of Directors for the Trade association, Association of Independent Consumer Credit Counseling Agencies (AICCCA). In the latter position he had direct contact with other CCA leaders who were also in the process of developing computer systems for their own agencies.

Second, NN provided intimate access to the computer program developers RR hired to ORG's client data and operating procedures as well as the industry's standards of practice. NN also permitted the use of ORG as a laboratory to test and refine these software products. This permitted RR to ultimately create a program to meet ORG's as well as the industry's operational needs.

Then, after the computerized system was fully completed, ORG began licensing use of the program from RR. There were no records provided regarding the process used in the selection of RR as the software provider. There also was no independent evaluation conducted that would indicate that the product was being provided at a reasonable fair market price.

The software created by RR is being utilized by ORG in the operation of its DMP program. This program also only had a value to a bona fide §501(c)(3) entity that could lawfully engage in debt management services, hence NN steered ORG to contract with RR.

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Utilizing ORG in this fashion contributes to his private benefit. See est of Hawaii v. Commissioner and International Post Graduate Foundation v. Commissioner.

Once the DMIS software was in place, NN then transitioned the back-office DMP processing functions to RR. While the Service acknowledges that the fees charged by RR for its services may be reasonable or even below market value, the issue to be determined is whether these arrangements provided a private benefit to RR and hence to NN as its owner.

The records provided regarding RR's selection as the DMP processor merely shows that a vote by the Board of Directors was formally recorded in the meeting minutes. However, the vote was cast by a single member of the Board and fails to reflect any deliberations or information regarding who, if any, the competing bidders were or the terms of their proposals.

The records that have been provided indicate a structured methodology to establish reasons favorable to RR's selection to provide both the computerized operating systems and the back-office management and processing of the DMP program without any bona fide competitive selection process. See Church by Mail, Inc. v Commissioner, 765 F.2d 1387, 1985 Christian Stewardship Assistance, Inc. v. Commissioner, American Campaign Academy v. Commissioner, and Retired Teachers Legal Fund v. Commissioner. Licensed.

**TAXPAYER'S POSITION:**

The taxpayer presented its position through its authorized representative, NN (NN), via letter dated November x, 200X.

NN asserts certain facts in arguing that ORG' has a charitable and education program:

1. Debt-counseling is provided to lower-income individuals
2. ORG only charges a \$x start-up fee
3. ORG receives only a maximum per month fee of \$x
4. ORG produces and disseminates educational materials (publications and audio/video tapes)
5. ORG provides educational materials to churches, social outreach agencies, etc.
6. ORG provides grants to other tax-exempts providing debt counseling services
7. ORG conducted x counseling and educational sessions prior to any consideration of a DMP as opposed to a net x% of callers that enroll in a DMP program
8. The main source of support is derived from corporate financial institution creditors



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**REBUTTAL:**

The Service disagrees with virtually all of the facts as presented by the taxpayer's representative.

With respect item number one, this may or may not be applicable as no process was instituted that would screen potential debt management participants based upon this criteria. This criterion was not addressed in any advertisements, commercials, scripts, training, its website, or any other materials submitted. ORG has provided no evidence that its DMP program was operated with regard to any income limits.

The Service agrees that start-up and monthly fees were charged in connection with the DMP and that in the majority of cases was reasonable.

NN asserts in items four and five that various educational materials were distributed. However, records regarding the distribution of any materials educational or otherwise were not provided to the Service. The Form 990, Part II, Statement of Functional Expenses does not report any significant expenditure for either postage or printing. The distribution of proposals to solicit potential DMP clients by showing them the saving that can be obtained through enrollment is not an educational activity.

At item x NN asserts that grants were made to other tax exempt organizations. Instead, the Service consider the sharing of fees with regard to "fair share" payments under DMP clients obtained from these other entities as grants. Instead, we would consider these revenue sharing arrangements from a commercial activity as evidenced from the partner agreements.

NN asserts at item seven that only x% of the total call volume results in DMP clients. He incorrectly concludes that the remaining x% of the callers were therefore provided pure education. We disagree. The telephone script utilized by counselors contains no educational content but does involve somewhat of a screening process as all callers may not be able to qualify for the program or merely be calling for information only. Nonparticipation in a DMP does not default to providing educational services.

The Service agrees in section eight that the major sources of revenues are derived from "fair share" arrangements with creditors. These payments represent typical industry standard arrangements where collection agents, here ORG, receive a portion of the funds collected on behalf of the creditors. This is in essence a discounting of the creditors receivables to facilitate collection.



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**CONCLUSION:**

As a result of its substantial unrelated business activities and the private benefit provided to RR by supplying a stream of DMP accounts for processing, ORG has not operated exclusively for charitable and educational purposes within the purview of §501(c)(3). Exemption is revoked as of January x, 200X.



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