

Appeals Office
701 Market Street Suite 2200
Philadelphia PA 19106

Release Number: **201033042**
Release Date: 8/20/10
Date: May 27, 2010

A

B

UIL – 0501 .33-00

Person to Contact:

Employee ID Number:
Tel:
Fax:

Refer Reply to:
AP:FE:SAC:DFF

In Re:

Form Required to be Filed:

Tax Period(s) Ended:

Form Number

990

Employer Identification Number:

**Last Day to File a Petition with the
United States Tax Court, United
States Claims Court, or the District
Court of the United States for the
District of Columbia: AUG 25 2010**

CERTIFIED MAIL

Dear

This is a final adverse determination as to your exempt status under section 501(c) (3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code, effective January 1, 2004.

Our adverse determination was made for the following reason(s):

You are not operated exclusively for charitable, educational, or other exempt purposes as required in section 501(c)(3). 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).

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 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 form for 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. 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. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency. See the enclosed Notice 1214, Helpful Contacts for Your "Notice of Deficiency", for Taxpayer Advocate telephone numbers and addresses.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Charles Fisher", with a long horizontal stroke extending to the right.

CHARLES FISHER
TEAM MANAGER

Enclosures:

Notice 1214 Helpful Contacts for your 'Deficiency Notice'

Internal Revenue Service

Department of the Treasury
Atlanta

Date: August 10, 2007

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

A

B

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.

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:

Taxpayer Advocate
MS 1005
210 E Earl Dr
Phoenix, AZ 85012-2626

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 by Michael A. Ross
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG (ORG)		Year Ended Dec. x, 200X & Dec. x, 200X

Legend

ORG= Name of organization

LOC= Location

NN= Name of individual

ST= State

POS= Position

TIT= Title

CY= City

IND= Index

x= Amount

X= Year

RR= Related organization

UR= Unrelated organization

Date= Day, date

PRO= Systems

TO= Training organization

FACTS:

(A) Background – Exempt Status

ORG (ORG) was incorporated on July x, 200X as an ST non-profit corporation. ORG received their advanced ruling letter on January x, 200X and their final determination letter on April x, 200X. The final determination letter classified ORG as not being a private foundation by reason of sections 509(a)(1) and 170(b)(1)(A)(vi).

ORG Articles of Incorporation contain general section 501(c)(3) language providing no insight about their exempt purposes. However, the Articles describe its character of affairs as “assisting needy debtors to improve their finances through educating them as to better means of managing their money and through seeking for them, if appropriate, an extension or other reorganization of their debts”.

As addressed in its application for exemption, ORG states its intended purpose as follows:

“(ORG) was formed to help reduce the incidence of personal bankruptcy by (i) educating the public about personal money management skills and (ii) assisting needy individuals and families with their financial problems. (ORG) will initially address these problems in x ways: providing information to the general public on sound money management, counseling individuals and families who have financial problems and preparing budget plans for those individuals and families who can benefit from them.”

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(B) Board of Directors, Officers and Key Employees – Management Structure

ORG is operated and controlled by a small number of individuals. The President is NN (NN)¹, while the treasurer is NN; both were elected on the date of incorporation. The Board of Directors included attorney NN and NN, both elected in January of 200X.² NN, a retired TIT, is NN's Brother-in-Law. NN and NN both worked at UR, NN for x years and NN for x years.

(C) Overview of operations

In providing an overview of the operations, we will start by describing how ORG obtains clients, the counseling process, and correspondence sent to the clients as part of the process. This section will describe essentially how they get clients and what happens from the first to last contact by ORG.

Obtaining Clients

While ORG did have some yellow pages advertising and received some clients from the internet, they found this was not a very cost effective way to obtain clients. ORG main source of clients was through the purchase of leads. Their main supplier of leads was UR.

NN provided oral testimony that ORG employees would attempt to contact leads x times. If they were unable to reach a lead, it was dropped as an active lead. He also stated that out of x leads, approximately x-x% were successfully converted to debt management plans (DMP).

Processing Leads

The leads provided to ORG consisted of very basic information, including some or all of the following information: Names, Address, Phone Numbers, Debt Amounts, Source of the Information, whether or not the lead was Spanish speaking, and some contained additional comments provided by the lead.

¹ NN's wife, NN, was elected as the Vice-President when the entity was created as shown in the annual report filed with the State of ST. As of 200X, she was no longer listed as an officer.

² NN was elected to the board in October of 200X as shown in the annual report filed with the State of ST. He was not listed as a Director on any Form 990 and was not listed on the next annual report filed with the State.

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While the PRO is set up, so that the lead information could be imported into the system, NN indicated that generally the leads purchased could not be imported, because of how they purchased leads. Instead they would need to be added to the system, as the employee contacted the lead. Usually, the employee would receive some printout with the lead information from their manager and they would use the "Add/Edit Lead" function to add them into the PRO. While ORG did have some scripts available, these were primarily for training purposes. Generally, the ORG employees used the PROs to direct the call flow.³

PRO

It should be noted that PRO is a RR product that ORG was required to use per its fulfillment agreement with RR. The Fulfillment Agreement indicates that the Debtor file that ORG gives to RR must contain the DMP and any documentation necessary for RR to deliver the services. RR provided PRO to ORG for those purposes.

Since the PRO was used to guide the call flow between the ORG employee and the leads, understanding this system and its use is critical to understanding ORG counseling activities. The PRO Screens provided by ORG are included as Attachment 1. A key feature of PRO, and key to understanding its use, is the ORG employee is not able to go to the next screen until they have finished the information on the current screen. Therefore, it is important to note the order in which the screens appear in the system, as follows: Personal Info page, Prequalifier, Debt Options, Budget, Counseling and Education page, Opening Presentation, Amortization Screen, Closing Presentation.

Therefore, in processing leads, the ORG employee would fill in any required entries into the PRO using responses obtained by the leads. Additionally, in using this instead of a script, the ORG employee was then supposed to cover any items that the system brought up as a result of information input. To fully understand this system, we must look at how the ORG employee used each of the individual screens as part of this process.

Screen 1

The first screen is the Personal Info page. This is simply contact information requiring very little explanation.⁴

Screen 2

³ This was verbally confirmed by both NN and one of the remaining two ORG employees working as counselors.

⁴ Near the bottom of page 1 are 5 fields labeled, Source, Vendor, Status, Preferred Phone Number, and Referred Client ID. When a counselor was specifically asked about these, she stated they never used those fields.

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The next screen is the Prequalifier screen. As stated in the training manual, this screen is used to determine if the person may qualify for a DMP. The information gathered on this page includes: renting vs. owning a home and if those payments are current, # of people in the household, # of sources of income, possession of checking / savings account, types of bills / debt owed and total debt owed, debt service payments, amount the lead believes they can spend to service the debt, and whether they are current or behind on payments.

About 1/3 down the page on the right hand side is an area that indicates "Click here to counsel on:" The ORG employee who had been working as a counselor at ORG the longest did not use this and had no idea what happened if this link was clicked.

As the screen title implies, the information collected here is very basic information and it helps the ORG employee determine if the lead qualifies for a DMP. The last item is a check box only, asking the caller why they want to join the DMP. Neither the training material nor the ORG employee interviewed indicated that ORG uses the response from the last question to provide counseling. Instead, this question is asked as part of a sales technique to get the lead to start to think not whether they should get on a DMP, but to accept that as a fact, and get them to state why they want to get on a DMP.

Screen 3

After obtaining the limited information from the Prequalifier screen, the next screen is the Debt Options screen. This screen requires the ORG employee to ask a series of questions. Some of the questions after being filled out by the ORG employee trigger the program to populate the program with additional text. The only example of additional text that was documented by ORG was on the question "Have you tried to obtain a loan?"

The additional text, if the answer is 'no' covers the following:

- Loans do not eliminate debt, it only transfers the debt owed, and therefore an important aspect of taking a loan is the payment amounts and the interest rate.
- If the amount is affordable and the rates are less than the current rates being paid, a loan might be a good option.
- The amount a creditor will lend on unsecured loans is relatively low and the rates are usually high.
- Unsecured loans are very difficult to qualify for if you have marks on your credit, a lot of debt, or a low credit score.

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- If the consumer has equity in their home, they might want to consider home equity loan options. Ask them if they are interested?

Other questions the ORG employee asked while at this screen include: Have you considered bankruptcy?, Do you have other assets such as equity in their home or friends or family that can help them⁵, Have you performed a comprehensive analysis of your finances at home?, and Are you prepared to provide me with detailed information concerning all your monthly expenses at this point or would you rather handle that at a later date?

It is unknown if we were provided all parts of the debt options page. While documents provided show some of the additional text the PRO provides, it does not show all of them. Additionally, the current ORG employee, working as a counselor the longest, verbally testified that she did not remember the additional text popping up; she instead thought these were simply a list of questions that were asked one after the other in order to get to the next screen.

Screen 4

The next screen is the Budget Screen. This screen allows the ORG employee to input Net monthly income, and various expenses. The expenses included one line each for Housing, Transportation, Food, Clothing, Misc., Savings, Credit Cards, and Medical Bills. The program then calculates cash flow. The ORG employee verbally confirmed that while taking the budget, she would generally have to prompt the individuals for the various sources and what she would do is tally them up on scratch paper and enter the total when they got all the income and expense items listed.

While the manual makes it clear and the oral testimony provided by NN indicates that every page must be filled out before the next page could be viewed, we are not sure this is the case⁶. The current ORG employee, working as a counselor the longest, verbally testified the budget page was for DMP purposes only⁷. She stated there was no reason to make them go through the budget steps, if they knew they wouldn't qualify. However, the next day when asked about how they would skip the budget page, because they knew the person would not qualify, to get to the education page, she indicated that they probably wouldn't do this. She stated it was

⁵ The PRO training manual indicates additional text will appear based on the response to this question, but this additional text was not documented by the manual or anything else provided by ORG.

⁶ Oral testimony provided suggests that screens could be skipped or the ORG employee could simply quickly fill out the data needed with "dummy" information to get to the next page.

⁷ Occasionally, there will be borderline cases, where she would think they would qualify, and they wouldn't after filling out this page or that she had to fill this out to make certain if they would qualify, but these were exceptions to the norm.

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helpful for people to do a budget, even if she knew that they would not qualify; saying some people had absolutely no clue where their money was going each month.

However, based on the PRO manual, after completing this screen, the ORG employee knows whether or not the person qualifies for a DMP and whether or not they will be offered a DMP. If this were not the case, the next two screens would not make any sense, as we will discuss.

Screen 5

The next screen is the Counseling and Education Screen. The training manual indicates the items on this page should be read to the caller. It also states the following questions affect the display of information on this page:

- Prequalifier page: 'Are you current or behind on your creditor payments?'
- Debt Options page:
 - 'Have you tried to obtain a loan?'
 - 'Have you considered bankruptcy?'
 - 'Do you have any other assets such as equity in your home or friends or family that can help you?'

The full extent of the information available on this page is unknown. ORG provided different printouts of this screen, but it is not sure if all items that could possibly be on the page were documented by ORG. For example, the ORG employee interviewed thought additional items were somewhere on the system, she was not sure where, but she remembered there being additional items.⁸

Of the items actually documented by ORG, if the caller is behind on their payments they are to 'educate' them about the damage delinquency on debt can cause: to include Bad Credit, Penalty Fees, Interest Accumulation, and Debt to Income Ratio.

In explaining Bad Credit, they point out that delinquency is the single biggest factor accounted for in credit scores and that it is the fastest way to damage their credit worthiness. In explaining Penalty fees they remind the caller that credit card companies make most of their money by charging late and over-limit fees, as much as \$x-x per card per month. They also state that these fees can be much more than the amount of interest charged for the month.

⁸ While she could not remember exactly, in this case she provided specific information such as covering the various places where a person could attempt to get loans, such as credit unions, etc. While we were looking at the Debt Options screen at the time she mentioned this, this screen would seem to be a more appropriate place for something like this.

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They are to inform callers about Interest Accumulation explaining if they are making minimum payments it goes to interest and the balances may not go down. They warn that simple purchases like food and clothing can take years to payoff and cost many times the actual price and tell the callers that the inability to pay off bills due to unaffordable payments and interest accumulation is sometimes referred to as "debtor's prison".

The next item is Debt to Income Ratio. The screen states they should calculate the ratio and that it should be no higher than x%. They explain the ratio is a measure of outstanding debt to monthly income, that a high ratio can significantly affect your credit and make getting loans with reasonable terms difficult or impossible. It may affect your credit score as much as a delinquency. A goal of debt management is to reduce this ratio. Finally, if making minimum payments, it will take a long time to reduce the ratio.

The next section on the Counseling & Education Screen is the debt options. The first option is handling the debt on your own. The way this option is worded, as seen in Attachment 1, even though they are giving this as an option, they are doing so in a manner suggesting this is not a good option. Option 2 is obtaining a loan. Again, even though they are giving this as an option, they are doing so in a manner suggesting this is not a good option. They do explain that if they can find a loan with affordable payments and an interest rate "that is considerably less than you are currently paying, a loan might be a good option for" them.

The third option is bankruptcy. Again, they don't indicate this is a good option, but do discuss it. There is also a note at the bottom that if "budget counseling still produces a negative cash flow; bankruptcy may be their best option."

The information provided by ORG indicates that the information on the x options presented on this screen is constant, meaning the information does not change based on the callers circumstances. The same option presentation is provided to every caller, regardless of the individual's circumstances.

The last comments made in the bankruptcy option are also revealing. By this point, ORG has done their budget analysis, however, here they are to say "We should exhaust all of the other options and do a careful budget analysis before this (bankruptcy) should be considered."? If they didn't do a careful budget analysis why are they discussing the callers' options?

The items on Screen 5 do contain helpful information. However, in context, they appear to be used as selling points for the DMP.

Screen 6

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The opening presentation is the next screen page. This is the part of the sales pitch where they essentially introduce the DMP. It states "your best option may be our program"; and then goes on to explain the benefits of the DMP and the very basics of how the DMP works. See Attachment 1. Again, this screen is the same regardless of the callers' circumstances.

This again indicates that this screen would only be read, if the person qualifies for a DMP. If they did not qualify, or if the ORG employee was not going to offer them a DMP, they would not tell the caller "your best option may be our (DMP)".

Screen 7

The next page is the Amortization screen. This screen is used to obtain specific creditor and debt information from the caller, and provides more specific benefits that the creditors will allow on each account. This page relates only to the DMP.

Screen 8

The last screen is the Closing presentation. It starts with "Great, now that we have reviewed all of your options it sounds like our DMP is going to be the option for you!" This is an inaccurate statement. On Screen 5, the ORG employee didn't "review all of the options", they simply read information about options that were standard for all callers. They certainly didn't discuss the advantages and disadvantages of each of the options in the context of the person's financial situation.

This last screen ends with the ORG employee explaining that ORG will be sending the caller the agreement and giving them general instructions on what they will need to do to start the DMP. At this stage of the ORG / lead relationship, the lead would then have to make the decision about whether or not to agree to enter the plan. If they agreed, the ORG employee would fax or email the lead an application from the PRO. The lead would be asked to sign the part of the application containing the debt management agreement and send in their first payment.

Application Package

The application package, as provided by ORG, was an email application sent to a client. This was consistent with the PRO's option to email an application to a client. It contains a cover letter, the client agreement, an authorization to release information, a creditor information sheet, and a budget sheet.

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Cover Letter

The cover letter is part of the sales pitch to sell the DMP. It starts off congratulating the client on taking steps towards financial freedom. It provides the application to the client, indicating that all information must be provided so the proposals can be processed completely, and provides instructions to hopefully allow the client to do this.

As part of the sales pitch, the letter states, "You have already been pre-approved for our program, but to ensure you receive a spot it is very important that you fax back the information within 48 hours." Creating this sense of urgency is a matter of sales, it is meant to increase stress levels and to get the consumer to make a faster decision than what is necessary.

While there is no educational content in the cover letter, it does indicate that if they have any questions, they should call ORG back. Additionally, ORG provides contact information for the local BBB to ease fears a consumer might have in using their services.

The cover letter is signed by the ORG employee using the title, Financial Consultant.

Client agreement - - Contributions – Fees for Services

In the agreement, the client signs that there are no "advanced fees" charged, but that they have been requested to and have agreed to pay x% of the total debt that ORG is handling for the client. It further indicates this will approximately be one monthly payment on the DMP. The contract also discusses the client has been asked to make a voluntary "monthly" contribution of \$6 per account that ORG is handling. The contract makes it very clear that these contributions are voluntary, and that ORG will assist them regardless of whether they contribute or not.

Earlier in the contract it states that the client should continue to make payments to the creditors and that payments may not be made to the creditors by ORG during the negotiation process (x-x days after receiving signed agreement along with any contributions they agreed to pay). It states further that due to this, the client may fall behind with the creditors.

Authorization To Release Information

This document gives ORG the ability to contact and get information from creditors. There is no educational content intended or attempted with this document.

Creditor Information Sheet

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This sheet allows the client to list the creditors and all needed information to sign them up for a DMP. In addition to sending this back, the first page of the application asks the client to fax in all their current statements from the creditors they will be "consolidating". Again, there is no educational content intended or attempted with this document.

Budget Sheet

This is a budget sheet sent to the client with instructions to fill it out and fax it back. This is the same essential information covered during the phone call with the client. It requests income and expenses only. It does not request assets held by the client that may be used to pay off debt or other liabilities that could also affect their financial situation or otherwise provide the person's complete financial picture. Because of the lack of information requested and the lack of interaction with a counselor, we do not consider sending the client a blank budget sheet and asking for income and expenses part of an educational process.

Therefore, the application package is simply an application and there is no educational content. The purpose of this application is to sign the client up for a DMP.

Application Returned from Lead

Once the signed debt management agreement and first payment are received, the lead is promoted to a "consumer" in the PRO. ORG will send a Welcome Package to the consumer and at the same time ORG would submit the information to an unrelated back office service provider and keep the "contributions" made by the consumer. Back office operations, which include, DMP proposals and all negotiations to set up the DMP, receipts and disbursements of all debtors' funds, trust account reconciliation, and customer service have been outsourced to RR, which replaced the RR Group effective January x, 200X.

Any contacts made by the consumer or client are now to be made with the service provider, and not ORG. With the transfer of the processing to the service provider, ORG essentially severs their relationship and all contact with the clients, except the Welcome Package previously mentioned.

Welcome Package⁹

⁹ The Welcome Package discussed is the one provided by ORG as the package available during the audit period. The Welcome Package currently available is similar to the one discussed.

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As this is essentially the last contact ORG has with consumers, this is the last opportunity for ORG to educate its clients. ORG has indicated that during the audit period, this was sent to DMP clients after they had returned a signed application. It is currently available online to anyone. The ORG employee interviewed, NN, indicated that she encouraged all DMP clients to read this packet of information.

This packet covers the DMP benefits, including access to Client Services Representatives (CSRs) for DMP information, continuing education, and account updates. It also has testimonials from other ORG clients. It makes it clear that the clients should call the CSRs and not the ORG employee who set up the DMP. The CSRs are employees of the back office service provider. It further explains that the CSRs have the ability to help with DMP or account-related matters, but that they do not provide additional counseling, educational support, or budget assistance. For those matters, they are to call the CSRs who will put them in touch with a counseling representative by scheduling an appointment with a professional credit counselor.¹⁰

The package goes on to describe Key Responsibilities and Guidelines for Consumers. This section discusses the DMP payment options, adjusting creditor due dates, sending a payment to the creditors the first month of the DMP, having patience, late or missed payments, monitoring creditor statements, reading proposal status updates, answering creditor calls, letting (RR) know about collection calls, sending partial or additional payments, maintaining a regular budget, and informing (RR) of withdrawal from the program.

Each of these items contains a paragraph of information¹¹. All items except maintaining a regular budget relate directly to the DMP, and contain no educational content. The budgeting paragraph is limited to "encouraging" them to evaluate the household budget, "as this could save you money" that could be used to pay the debt off faster. We will discuss the budget itself in more detail later, but for these purposes, this paragraph itself is not an educational activity.

The packet then contains contact information, which is the contact information for RR, since they were processing payments and handling all aspects of the DMP once it began during the audit period¹². The next two pages are payment coupons for the DMP.

¹⁰ No where does it imply that these professional credit counselors are employees of ORG and ORG did not make this claim either. ORG did not indicate that any clients called them for education after they had been sent to the service processor for processing.

¹¹ Except the first sections on payments as there is a paragraph for each type of payment that is possible.

¹² As stated before, in later periods under audit, the back office service provider changed to RR. However, the concept is the same that ORG would no longer be the contact point.

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The next 4 pages are the budgeting forms and instructions. This is an attempt to provide the client with budget forms, that if completed by the client, might show individual budget items which could be cut back on to reduce the client's expenses. However, a detailed look at the budgeting forms shows their limitations as good budgeting aids and as educational tools.

The instructions for the budget sheets and the budget sheets themselves are not conducive to creating a budget. Page 1 of the budget sheets has line items for assets and equity as income items. This would be fairly confusing to someone filling this out without assistance. Additionally, the totals from Pages 2 and 3 are to be transferred to page 1, but there are no lines available.

Just as in the counseling sessions, as evidenced by the discussion under Screen 4 of the PRO, the budget sheets provided with the Welcome Package do not get a full financial picture of the client, as not all assets are entered and there is no information related to potential sources of equity that could be tapped to pay off debt. Additionally, it is post ORG involvement and is not required for DMP participation. No one ever covers the budget or budget items with the client, and so it is simply a blank document sent to the client which may or may not ever be looked at by the client. ORG has no information to support that any client ever used this for budgeting purposes.

The next page of this package contains budgeting tips. These are generic tips that have nothing to do with the particular financial situation of any client; meaning they are not tailored to individual needs. They are similar to tips that can be obtained from any number of sources, and appear to be plain common sense. Again, this is after the fact that ORG offered a DMP to a client and there is no interaction with ORG and the clients pertaining to this specific sheet.

The last item in this package is their Privacy Policy, which obviously is not intended as part of an educational activity.

Documentation of Counseling Sessions, Past and Present

ORG did not maintain detailed records of actual counseling sessions, such as recordings or transcripts. Additionally, since ORG is in a transition where it is operating the back office operations it had previously contracted out, they are not actively trying to get new clients, although they do get new clients occasionally through referrals from existing clients. Mostly the employees now handle calls from current client who are calling up about something related to their DMP. These calls would not be representative of the calls during the audit period.

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Even though they did not maintain recordings of the calls, ORG did maintain files on the clients that they did talk to. To be more specific, they maintained records of “package documents” that were compiled on the clients which were then transferred to their back office service provider who would complete the DMP process with the creditors and the clients.

The “package documents” were provided by ORG in response to requests that they document what occurred during the counseling sessions during the audit period. We hoped this information would confirm or show that more information was collected during the sessions than simply the information in the PRO and to provide documentation that they provided education to their clients.

The budgeting information provided with these files suggested that it made no difference what the budgets said, the clients were still offered DMPs. Actually, it is more correct to say that the clients were offered DMPs, before all the budgeting information was provided. Additionally, some of the budgeting information showed that either some clients were not in a position that they needed the assistance available through a DMP, or they didn’t fill out the budget information correctly. Either way, this is not seen as a positive factor for ORG. It indicates that they did not pay particular attention to the budgeting information that was supplied by its clients. This would make it impossible to provide credit counseling in the first place. Additionally, there was nothing contained in the “package documents” that suggested ORG collected more financial information than that noted above nor provided any type of education beyond which was done in filling out the PRO as previously covered.

Overall, the package documents provided confirmation that the information collected during the counseling sessions was limited to the information requested in the PRO. While, it is clear that not every single topic discussed would be documented, it is apparent that clients were essentially offered DMPs before all budgeting information was obtained. Furthermore, the documentation specifically lacked any substantiation that any specific education was provided to any specific client.

(D) ORG Employees

Hiring

NN provided oral testimony that ORG hired individuals primarily through local advertisements. CY, where ORG is located, has numerous customer service sites and call centers that provide a large pool of appropriate workers. He stated the criteria was simply that the people have phone skills and could be empathetic to a person in debt.

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We were unable to obtain any advertisements to confirm or refute the oral testimony about ORG hiring practices.

Employee Manuals

While the employee manual covers many items that are not relevant to this discussion, it also provides some insight into ORG operations and activities. The services the manual indicates that it provides to consumers relate to a typical DMP, lower payments, reduction or elimination of interest, fees, and charges, etc. It then goes on to say ORG "is currently designing educational programs and lectures in money management, budgeting, rebuilding credit and savings. The manual is very clear, they are actively involved with DMPs, but they were in the process of designing educational programs.

In discussing compensation, the manual references "individual and company performance". The manual implies that as ORG performs financially well, so too may the employees. In this respect, the manual does not indicate that compensation is related to or tied to how well an individual educates its clients.

ORG, in the manual, also emphasizes the competitive nature of the work it performs. It is clear that ORG competes to enroll clients in its programs, and the ORG employees need to be aware of that. They make this known in several ways: employees may not disclose ORG documents subject to termination or legal action, ORG reserves the right to terminate any employee whose family members are employed or have a vested interest in a company that is directly or indirectly in competition with ORG, and all employees must sign Confidentiality and Non-Competition Agreements before employment with ORG can begin.

Employee Handbook

This handbook was created and copyrighted by UR. It contains very general information about ORG as an employer such as explaining their total quality management, sexual harassment policy, pay and benefits, and other misc. items. It contains no reference to how ORG operations are run.

On the other hand, NN created a welcome letter for the front page of this handbook. In this he makes the following comment "Our goal is to provide the finest-quality services to our clients and to do this more efficiently and economically than our competitors. By satisfying our clients' needs, they will continue to do business with us and will recommend us to others."

Training

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NN provided oral testimony about ORG training. Newly hired employees were hired for a x day probationary period. This started with approximately x weeks of on-the-job training. This was a classroom setting for the first week and then role playing the second week. No documentation was provided that was specifically identified as being covered during this x week period.

The remainder of the x day period was spent on the phones where the new hires were provided some of the unproductive leads or other low priority callback calls. The new hires always had the ability to put callers on hold and get direct support as needed from other employees or their managers.

This x-day period was used by ORG to ensure that they had a quality employee and that they could be depended on to remain with the company for some time. Since the TO training was costly, they would not train the employee with the TO course until sometime after the probationary period.

TO Training & Certification

The TO course was completed, at least in part, during work hours at ORG. ORG provided a bound manual that ORG employees used to train for the TO certification. One counselor indicated that the training lasted for two weeks at x afternoons per week. Another counselor that attended the same training sessions, indicated it was a few hours per week for a couple of months. While they did not agree on the time span of the training, they agreed that they spent a couple of hours per chapter. They then went to a local college to take the test to get their certification.

As stated earlier, the two current employees went through their training together; although they were not hired at the same time this was the case because it was the first time ORG paid to get their employees certified. This implies that the x-day probationary period resulting in the start of the certification process, may simply be a best case scenario, and that sometimes the certification process came much later than the xst day.

The materials used to certify their employees were reviewed extensively. Overall, the manual provides general training in communications skills, problem solving skills, and the credit and debt management industries. The personal finance and budgeting information is limited to x pages of information and consequently is very general. The training also makes the assumption that a DMP is part of the solution for every debtor, if they qualify. Therefore, there is some degree of marketing or sales training involved in that they are trained to get the

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clients to agree to or decide that they want to get on a DMP. While the manual acknowledges qualifying for and assumes the establishment of DMPs, this manual contains no such specific training for those purposes. This training will be discussed next.

Other Training

As stated above, the TO training materials do not provide specific training for ORG employees on how to process DMPs. However, ORG did provide additional training materials that they described as being part of informal training or guides for use that any ORG employee could use for conducting their work. We will cover all training items provided by ORG next.

While ORG did not provide specific information about the training that occurred during the x-day probationary period, we must remember that after the first x weeks of classroom training, the employees were put directly on the phones talking "to unproductive leads or other low priority call backs". In order to perform these actions, the ORG employees would have minimally had to have received training on how to use the PRO. We will discuss this first.

PRO Training Modules

ORG provided x training modules for use with the PRO, as follows:

- 1) PRO - Lead Management Module Training Guide, 11/x/200X Release,
- 2) PRO – Lead Management: Counselor Tools Module, Training Guide, 11/x/200X Release, 3)
- PRO Agency Administrator – User Guide, 11/x/200X Release.

These training guides instruct how to use the PRO. The most relevant manual is the xnd manual, the Counselor Tools Module, which is contained in its entirety in the first manual. This is a step by step guide to instruct users how to input items, how the system responds based on the information input, and provides instructions to the user on how to present the information while on the phones with a lead or potential client. This manual is substantially consistent in all respects to the description of the use of the PRO, as previously described.

The last module is a supervisor level manual; it is not for individuals who normally speak to the clients directly. It discussed maintenance of counselor security access, provision of reports, assigning and searching leads, etc. It does not cover what would be considered to be the day-to-day counseling activities conducted by ORG.

The PRO Training modules were used exclusively by ORG to train its employees to use the PRO. It contained no additional training for the counselors outside or in addition to this. There

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was nothing in the three training manuals provided that could remotely be described as training in counseling skills, personal finance, budgeting, credit or debt management, the development of options or recommendations for particular debt circumstances, or training to identify underlying personal problems of callers.

ORG Lead Management Prequalification Call

ORG provided this document, which it claimed the ORG employees would use as a guide. NN clearly indicated that this was not a script. This document was very similar to the PRO Training Module. In fact, this document simply discusses the PRO Screens, in a condensed format.

This form indicates that during the input of the PRO screens "approximations of the debt load and monthly payments are suitable." It also later indicates that if the budget shows a negative balance (normally indicating they will not qualify for a DMP), they are to notate this and "review the budget upon consumer completion of the paperwork." This indicates the clients are offered the DMP regardless of having a negative budget during the call.

The document covers going through the PRO screens and processing a return application, promoting a lead, and "Turning in the Hard File." This is an extremely short version of what the day to day activities of a front line ORG employee would consist of, as far as them dealing with the public at least. It also confirms the above information describing the use of the PRO.

Prequalifying a Potential Client

NN indicated this was used as training materials and that it was more like guidelines than it was a script. It gave the ORG employees background and good information. While this is not a script, it was used to help the employees perform their jobs better.

This document starts by explaining this "is probably the most important step in allowing you to be efficient with each client. If you do this step correctly, you will gain control of the conversations to come with the client. And what we mean by control is that the client will pay closer attention to everything you have to say from here on out. This will make it easier for you to have them fill out the information we need from them, give you a payment date that they know they can meet, and close the sale and get the first payment."

This document, including the above quote, seems to take some of the communication techniques that were described in the TO training materials and puts them in specific terms that will be used by the ORG employees. The purpose of this document is clear in that they are

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to prequalify a caller specifically in order to put them on a DMP. However, as stated by NN, it is not a script used by the ORG employees, it is only a guide.

Untitled Document, "Script"

ORG provided this document and NN indicated it was as close to a script as possible. The document closely followed the information from the PRO Screens, but simply has the questions, one right after the other. However, whenever he was asked about specific questions about the counseling sessions, he would generally refer back to handouts showing the PRO screens. Additionally, NN indicated at other times during the interview that the experienced ORG employees would generally use the PRO as the "script" for the counseling sessions.

This document does not add or detract from any of the other items ORG has provided as proof of their activities. It also indicates or assumes that callers will be approved for a DMP and explains the general benefits of a DMP, all before the ORG employee asks for a list of creditors with the approximate balances owed to each.

Prepare: Internet DMP Candidates

The last item of informal training materials provided by ORG includes this document containing pages x, x-x, and x-x. NN explained that this was a job aid or additional guidelines for the ORG employees that may have come in as part of ongoing education for the employees.

As the primary purpose of an Exempt Credit Counseling agency is to educate, special attention was provided to Pages x, x and x-x as they all start with the heading "x. Educate:" However, upon closer review, it is apparent for this document the term "Educate" means explaining the DMP, not providing counseling as part of an educational process. For example, consider the following quotes:

- Page x – They are to Put the Debtor at Ease by explaining the program, ending with "a good explanation will most likely result in a new enrollment".
- Page x – "What Effect will credit counseling have on my credit?"
- Page x – "What is secured debt and why can't I include it on the program?"
- Page x – "Why is there a negotiation period?"

All "education" discussed in this document relates directly back to the DMP.

(E) Other educational activities

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ORG Website

Using a web archiving service, we discovered that the website as provided by ORG was similar to the website in 200X, but not exact. The website, as it existed during the audit period is included as Attachment x, and is reviewed below.

Throughout the homepage and the pages linked directly to the homepage, the website discusses and promotes the DMP. These pages repeat sales pitches, such as claiming to have "the most beneficial program in the industry" and promoting the benefits of the DMP (lower payments, lower interest rates). All of these pages are directly or indirectly related to the DMP. While the website contained some static informational items that are generic in nature; they are difficult to get to¹³. Education is not a substantial purpose of the website. It is primarily used to inform people about ORG DMP, to encourage them to sign up for a DMP or to contact ORG specifically to get on a DMP, and to give them helpful advice related to the DMP for after they have signed up for the DMP.

Newsletters

The information provided by ORG was that the back office service provider provided its clients with various newsletters. Since this was not provided by ORG and it was only provided to DMP clients, they would not be considered part of an educational process. In fact, since they were only provided to the DMP clients, this provides further evidence that ORG places greater importance on obtaining DMP clients than it does in providing education to the general public.

Seminars

ORG provided one flyer regarding a debt counseling workshop. This was to be free of charge on Saturday, April x, 200X. NN stated that despite their attempts to advertise the event, there were no attendees. There were no other attempts made to provide seminars for the general public.

(F) Financial Information

Income

ORG sources of revenue are Credit Counseling Fees and an extremely small amount of interest income. The Credit Counseling fees include initial payments to set people up on DMPs

¹³ Informational items are generally only accessible from the Site Map, and not from links directly from the main pages of the website.

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and fairshare payments from creditors; both classified as indirect charitable contributions on the Form 990. They also include the monthly service charges for clients on DMPs, classified as direct contributions on the returns. For all practical purposes, their sole source of income is from Credit Counseling.

YEAR	200X	200X	200X	Total
Revenue				
Monthly Fees	x	x	x	x
Setup/Fairshare	x	x	x	x
Interest	x	x	x	x
Total Revenue		x	x	x
C.C. as % of Tot. R.	x%	x%	x%	x%

The term "fair share" refers to a payment made by the credit card companies who are receiving payments from their debtors via the DMPs set up by ORG. Typically, credit card companies pay a fair share, which is a stated percentage of debt, to credit counseling organizations that set up DMPs; the amount paid is determined by each separate creditor in advance. Credit card companies generally will only make "fair share" payments to organizations recognized as exempt under section 501(c)(3) of the Internal Revenue Code. On the other hand, credit card companies may pay a percentage to for-profit collectors or they may sell the debt out-right for a small percentage of the debt owed.

The fees charged to Credit Counseling clients are amounts paid for initiating DMPs and for monthly service fees. However, ORG has indicated that all fees are voluntary and the DMP contract also makes it clear that these contributions are voluntary and that ORG will assist them regardless of whether they contribute or not. While NN estimated the percentage of clients who opted out of paying the fees was very small, somewhere around x of x%, he did not have exact figures and indicated that those were not available.

ORG does not receive any contributions from anyone, either the general public or creditors, who are either not in a DMP or are not receiving debtors funds from the operation of ORG DMP activities. ORG receives no government grants or donations from private foundations. They receive no donations from community groups, churches, labor unions, or any other groups or private citizens. Furthermore, they do not have plans to start a fundraising program.

It should also be noted that ORG does not report funds received from their clients held in trust by the service provider to pay creditors as income on the Form 990. Generally, they have no

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The officer compensation is the compensation for NN. The information above shows his compensation to be fairly constant. This is also true in 200X especially in considering that they included his deferred compensation amounts when in other years they did not. However, it should be noted that his income as a percentage of total revenues has increased over the three years from x% of Total Revenues in 200X to x% to x% in 200X and 200X respectively.

Over the same time period, the salary for the remainder of the workers can be seen to drastically be reduced over the x years. This is due to the massive downsizing ORG has experienced over this period, as they went from a high of about x employees in 200X, to about x employees in 200X, to x in 200X with maybe x or x by the end of that year.¹⁴ As opposed to NN's wages, those costs have decreased as a percentage of total revenues over the x years from x% in 200X to x% in 200X to x% in 200X.

Occupancy

The occupancy expense rose from 200X to 200X due to a move from the large expansion that ORG experienced at that time. It remained relatively constant until 200X, as they remained in the larger space they had leased. Based on our observations in 200X, ORG had a lot of vacant space that they were paying for to an unrelated party, until they got out of their lease at LOC. This expense should fall drastically with their move to their current location at LOC.

Advertising

These fees are essentially lead generation fees with a very small amount of typical advertising fees. For example, in 200X of the \$x for this expense, \$x or x% was for lead generation. Lead generation fees are the fees ORG paid to purchase leads that they would then call as described above.

Processing Fees

These fees are also fairly self explanatory. These are the fees ORG paid to their back office service providers. While these fees appear to have reduced as revenues were reduced, they did increase as a percentage of total revenues during the three years above from x% to x% to x%.

Other Expenses

¹⁴ ORG currently has only x total employees, counting NN.

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Most of the remaining expenses either stayed constant as they related to occupancy, like insurance and utilities or they decreased with revenue as ORG level of operations decreased, like telephone and postage. However, one expense in particular did not follow this pattern; Legal Fees. This expense increased drastically in 200X, but this too was expected, as ORG filed for bankruptcy protection in that year.

(G) Misc. Topics

Relief of the Poor

ORG has never made any type of claim that their purpose is the relief of the poor. They do not take any steps to focus their services or operations based on the income level of their clients. While they do ask for income levels, they do not request documentation on them. They also do not ask for or maintain any information about family size or compare the geographical location of the family to determine what income level the family may be at. Therefore, a discussion of whether they are helping low-income individuals within the meaning of § 501(c)(3) is unnecessary.

Credit Repair / Debt Settlement / Debt Consolidation

Credit repair is a service that claims to do one of two things: some credit repair agencies contact the credit reporting agencies and obtain removal of inaccurate or outdated negative items from credit reports; other agencies claim to be able to remove some or all negative items, regardless of their accuracy.

Debt settlement is a service where an offer for less than the amount due is made to a creditor to satisfy a debt in full. This can be done in a manner that is detrimental or beneficial to the debtor, depending on the tactics used in performing the service.

Debt Consolidation is a service where a loan is provided or arranged for a debtor that will be used to pay off most or all of a debtor's unsecured debt. This will allow the debtor to have only one bill and will hopefully lower the overall payment and interest paid by the debtor over the term of the loan as compared to paying off the individual debts.

We have found no information that ORG is involved in any manner with credit repair, debt settlement or debt consolidation. While their DMP is sometimes referred to in documentation as debt consolidation, the help ORG provides to debtors, in this respect is limited to their debt management program.

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PRIMARY ISSUE:

Should ORG tax exempt status under 501(c)(3) of the Code be revoked, because:

Issue 1 – Its primary activities do not accomplish an exempt purpose?

Issue 2 - More than an insubstantial part of ORG activities are in furtherance of a non-exempt purpose?

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 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 6033(a)(1) of the Code provides, except as provided in IRC §6033(a)(2), every organization exempt from tax under Section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

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.

Section 1.501(c) (3)-1(d)(2) of the Regulations defines the term charitable to include, in part, relief of the poor and distressed.

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Section 1.501(c)(3)-1(d)(3) of the Regulations defines the term educational to include (a) instruction or training of the individual for the purpose of improving or developing his/her capabilities or (b) instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

Section 1.6001-1(e) of the Regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service found that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code. Its board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, which held the funds in a trust account and disbursed the funds on a partial payment basis to the creditors. The organization did not charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid. The organization did not make loans to debtors or negotiate loans on their behalf. Finally, the organization relied upon voluntary contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The Service found that by aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual

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and beneficial to the community. Thus, the organization was exempt from federal income tax under section 501(c)(3) of the Code.

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 counseling 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. The reference to "lending agencies" suggests that what are now called fair share payments were involved.

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

The organizations included in the above decision waived the monthly fees when the payments would 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.

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

The court held in *B.S.W. Group, Incorporated v. Commissioner of Internal Revenue*, 70 T.C. 352 that "It is with some reluctance that we conclude that petitioner is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial. Petitioner's officers, at least for the present time, serve without compensation, and there is no indication in the record that their personal motives are different from the stated purposes of petitioner. Furthermore, we are troubled by petitioner's assertion, on brief, that commercial consulting firms have not, in fact, shown any inclination to enter this particular field of consulting. Nonetheless, limiting our consideration to the materials in the administrative record as we must, we are unable to find that petitioner's primary purpose is educational, scientific, or charitable, rather than the conduct of an ordinary commercial consulting enterprise in competition with other commercial firms."

In addition, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In *St. Louis Science Fiction Limited v. Commissioner*, T.C. Memo 1985-162, April 2, 1985, the Court reviewed the annual convention of a science fiction organization. It held that while the conventions may have provided some educational benefit to some of the individuals involved, that social and recreational activities and private benefit predominated.

In *Church of Gospel Ministry, Inc. v. United States*, 640 F. Supp. 96, 1986 U.S. Dist., due to the taxpayer's failure to keep adequate records, the court held that the taxpayer failed to sustain its burden to show that it was qualified for federal tax exemption as a corporation

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organized and operated exclusively for religious and charitable purposes, as required under IRC §501(c)(3), and that it was further qualified to receive deductible charitable contributions under IRC §170(c)(2). The court found that as a prerequisite to an IRC §6033 filing exemption, it was necessary for the taxpayer to show it qualified as an IRC §501(c)(3) organization, which it could not.

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. Also, the existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

Similarly, 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 purposes that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'g 12 Cl. Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because it operated for a substantial commercial purpose rather than for the exempt purposes of providing educational and charitable services to unwed mothers and children. The services for unwed mothers and children were merely provided "incident" to the organization's adoption service business. The agency's operation was funded completely by the fixed fees charged adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. Moreover, the court found that "adoption services do not in and of themselves constitute an exempt purpose."

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. "Among the major factors courts have considered in assessing commerciality are competition with for profit

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commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

The Credit Repair Organizations Act (CROA), Pub. L. No. 104-208, § 2451, 110 Stat. 3009-455 (Sept. 30, 1996), 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).

Because 501(c)(3) organizations are exempt from regulation under the CROA, 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.

In FTC v. Gill, 265 F.3d 944 (9th Cir. 2001), *aff'g* 183 F. Supp. 2d 1171 (2001), the appellate court inferred that a credit repair organization that first promised a "free consultation," but charged fees in advance of the full performance of services was being operated as a charity primarily for purposes of evading regulation under the CROA.

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GOVERNMENT POSITION:

(A) Audit Observation Limitations

Before we discuss and analyze ORG operations, we first need to provide some clarification about what was available to be reviewed. As in most audits, we are not able to go back in time and actually observe an organization conduct the actual activities that they were conducting during the audit period. We must rely on documented evidence to show how they conducted their activities during the period of an audit. We also look at their current activities and try to determine how the prior activities would have been in comparison. This is the historical approach to examinations. This case is no different to other audits in that respect.

Many credit counseling agencies record their phone calls for training or quality assurance purposes, ORG did not do this. Therefore, there were no historical calls to listen to.

Additionally, ORG operations have declined to the point that they are not really similar to the operations during the audit period. As we have indicted above, for the period under audit, ORG employees were in the mode of obtaining additional clients. After signing up for a DMP, these clients would then be handled by ORG back office service provider. Currently, ORG is handling their own back office services, collecting from clients and dispersing funds to creditors. Since they only have two employees on the phones, they are no longer actively pursuing new clients in a manner similar to how they did during the audit period. Therefore, the current phone calls are not reflective of calls made during the audit period.

Nevertheless, it is appropriate to mention the current operations. NN verbally testified that the vast majority of the current work done by ORG is the processing of payments and handling of the clients accounts currently in a DMP. We found no evidence that ORG provides substantial education to clients in operating what now has primarily become a back office service operation. Education is limited substantially to the website and possibly newsletters that are restricted to the DMP clients.

On the other hand, during the audit, we did have access to substantial information to support how ORG was operated. This included the PRO used essentially as a script, training materials utilized by ORG in its operations, documentation made available to the clients, and documentation maintained on the clients by ORG. We also obtained verbal testimony from all but one of the current employees on the operations of ORG during the audit period.

The documentation reviewed was very consistent in documenting ORG operations and almost all of the verbal testimony confirmed these operations. Therefore, during our audit, we felt that

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we were able to get a full understanding of how ORG was operated ultimately from their inception to the present.

(B) Issue 1 – ORG primary activities do not accomplish an exempt purpose?

To meet the requirements of *section 501(c)(3)*, an organization must be both organized and operated exclusively for charitable and other enumerated purposes. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-1(d)(2), Income Tax Regulations.

ORG provides its services to the general public regardless of income. They have also never claimed to be operating for the benefit of the poor, so this will not be discussed in any detail. Additionally, the class of people ORG provides services to, debtors, have never been determined to be a charitable class and ORG is not making this claim now. Therefore, they are not operated for the benefit of the poor or any other charitable class. Section 1.501(c)(3)-1(d)(2) of the Regulations.

However, educational organizations are classified as charitable. 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. Section 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

Whether an organization operates exclusively for charitable purposes depends on the application of the operational tests set forth in the income tax regulations. The regulations provide:

An organization will be regarded as "operated exclusively" for [charitable] purposes only if it engages primarily in activities which accomplish one or more [charitable] purposes specified in *section 501(c)(3)*.

ORG operations during the audit period were fairly simple operations; centered around a call center with a limited number of supervisors. They predominantly purchased leads and the call center personnel used the PRO to gather information on clients. If a lead could afford payments on a DMP¹⁵, they would send them a debt management agreement, in the hopes that they would sign up for a DMP. If they did, they would generally collect the initial fee and send the package to a back office service provider for additional processing. The service provider would be the contact point for the clients from that point forward.

¹⁵ They were sometimes sent agreements, even if the budget indicated they couldn't afford the DMP payments.

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In providing full disclosure, we believe it was the intention of ORG to help their clients get out of debt. While at the beginning of its operations, ORG did charge one months payment as an initial fee, they reduced this charge to meet state requirements. They essentially charge the maximum amount allowed by the states. ORG also claims they offered their services without charge to anyone that did not want to pay the fees, and the documentation and agreement forms state the same. However, NN testified that it was a very small percentage that did not agree to pay this fee.

Since the entire purpose of a DMP is to reduce payments, interest rates, and fees, many of ORG DMP clients may have been helped. However, helping people and helping them get out of debt are not tax exempt purposes. In order for ORG to be considered an exempt organization, since they don't restrict themselves to a charitable class, they must accomplish their exempt purpose by being an educational organization.

Since the primary activity of ORG is the purchase of leads and the ensuing phone calls between the leads and ORG employees, for ORG to be exempt, we must find that these operations are educational. However, all evidence suggests that through these phone calls ORG was attempting to get the leads to sign up for DMPs, and we will explain how we determined this next.

DMPs have been around in this industry for some time. They are referenced in both rulings covering the credit counseling industry, Rev. Rul. 65-299 and 69-441. They were also mentioned in the two main cases dealing with the credit counseling industry, CCCS of Alabama and CCCS of Oklahoma. The simple fact that DMPs are offered is not the determining factor, but in what context are they offered. This is what we will look at to determine if ORG is operated primarily to accomplish exempt purposes, and we will have to look at numerous factors to make that determination. The Core Analysis Tool was created to assist in making this determination and this tool was shared with ORG during the audit.

Counseling Sessions

Financial Information, Extent or Level of Detail Asked About

The organization has provided Scripts and Job Aids, static screen shots from the PRO, the application forms sent to clients with the DMP agreement, Package Documents, and the training manuals for the PRO. We also interviewed both of the remaining phone counselors who worked for ORG, both of which had worked during the audit period. However, we are

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unable to obtain access to the PRO, as it was a web-based program that ORG can no longer access.

In reviewing and analyzing all of this information, we found that ORG obtained information about the type, amount and source of significant items of Income and Expenses. Then again, the materials submitted indicated that estimates would be sufficient at this part of the process.

As far as asking about other liabilities and loans a client may have, they would normally only ask whether or not the client owned a home and if they have thought about a home equity loan. They do not ask about any other loans a client may have, except to the extent that they are current on the payments.

Additionally, they never ask about other assets a caller may have, although this information may be volunteered by the caller. While the PRO screens indicate they are to ask about other assets, the employees indicated they did not. Furthermore, the input screens do not have fields they can use to collect this data. ORG never obtains information that in anyway resembles a client's balance sheet, at any time during the counseling process.

Therefore, it seems clear that they only ask about financial information to the extent necessary for the counselor to qualify them for a DMP.

Budget Finances and Related Topics Discussed

Part of educational counseling sessions would include discussions about a client's budget and finances, including their employment, education, buying habits, significant expenditures, and any significant past or anticipated changes in their earnings, assets, expenses and liabilities, including the reason or cause for those changes. The documents provided do not indicate anywhere in their dealings with clients that any of the above items were discussed with clients. They only covered the income and expense items previously mentioned.

In an interview with one of the remaining counselors, they specifically indicated that employment and education were not required topics, although they stated that occasionally these might have been brought up by the clients. As far as buying habits and significant expenditures, this would have been covered only to the extent necessary to fill out the budget page in PRO. Additionally, while it was not required of the counselors to ask, many of the clients would explain why they got into debt as part of the conversation.

It was clear from the documentation provided that counselors generally did not interview

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clients about their budget and finances except to the extent necessary to qualify the client for a debt management plan.

Development of Options and Strategies

Part of educational counseling sessions would include the development and presentation to clients of a number of options and strategies for addressing their debt problems, including creating and maintaining a budget, establishing debt management payment plans with creditors, negotiating directly with creditors on payment or interest rate relief, and filing for bankruptcy. These options and strategies would be based on complete financial information and discussions of employment, education, buying habits, significant expenditures, and any significant past or anticipated changes in their earnings, assets, expenses and liabilities, including the reason or cause for those changes.

Based on our examination, we found that ORG Employees did inform clients of different options as they were following the PRO screens. However, we found that the information provided on the client's "options" was done so before the limited budgeting information was obtained from clients. This was mostly done while the ORG Employees were at the debt option screens. For reference purposes, the budgeting screens were next in the PRO.

Additionally, although they did get income and expense items from the clients, necessary for the DMP, they did not educate their clients on creating and maintaining a budget. While they informed clients about negotiating directly with creditors, they routinely discouraged the clients from negotiating with creditors, stating, "Some consumers try to get better rates on their own but creditors are often reluctant to give better rates if a consumer has a less than perfect payment history or a good amount of debt."

This strategy, essentially a DMP sales technique, was used when informing the clients of the non-DMP options available. They explain the option and then explain why it is not a good option, and again all before getting the budgeting information from clients.

Finally, to be part of an educational process the options presented must be based on a client's financial circumstances. The options presented, and essentially discounted, had nothing to do with a client's circumstances, as ORG had not determined what those circumstances were at that point in the calls. Therefore, this is clearly a negative factor, because they don't obtain the necessary information in the first place.

On the other hand, ORG feels it is important to point out that DMPs are not the only options presented to its clients, because as we stated before, the clients are informed that other

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options exist. Additionally, the counselors interviewed were insistent that they really did try to help their clients. For example, they explained that if they could not afford the payments on a DMP, they would recommend the client call a bankruptcy attorney.

We specifically asked one of the counselors if they ever found a client who made too much money to be put on a DMP. Without hesitation the counselor stated, "No", explaining that these people clearly needed help.

Overall, we believe that although ORG explains different debt options to its clients they do so in a manner that discourages the other options in an attempt to sell DMPs. We believe that in clear cases where the client cannot afford the DMP payments, they would do the correct thing and recommend they speak with a bankruptcy attorney. However, at the other end of the scale, one counselor said that they never found people that could afford to pay their own debts without the DMP. This seems to make it clear that the option endorsed by ORG was the DMP, and if they simply wouldn't qualify, which is generally determined by standards created by the credit card companies, they would suggest calling a bankruptcy attorney.

Advantages and Disadvantages of All Options Discussed

Part of an educational counseling session would include a discussion of the advantages and disadvantages of various options with clients. The counselor would then make recommendations for which options are best suited to meet the clients' individual needs, goals and circumstances.

As was stated before, the clients were informed of possible debt options, but this was done before budget information was obtained. While they did give generic advantages and disadvantages of the options, it was skewed towards the disadvantages of the non-DMP options. Additionally, since the options were explained to the clients before income and expenses were obtained, they were unable to properly discuss the advantages and disadvantages of the options in relation to the client's individual needs, goals and circumstances.

Referrals to Other Organizations for Appropriate Support Services

Part of an educational counseling session would include referrals to other organizations for appropriate support services, such as employment, training, and psychological counseling.

ORG was able to produce a sheet of x phone numbers for numerous agencies that could help with other support services, including AA, Career Information & Services, Child Abuse &

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Neglect, Federal Relay Services, Domestic Violence, Mental Health, and Drug Treatment help lines.

However, our interview with one of the counselors confirmed that this was rarely done, and that they did not interview or otherwise attempt to determine if any of these items would be appropriate. The counselor indicated this was akin to an invasion of the callers' privacy. He did state that in the process of conducting their sessions with the clients, occasionally a client would "open up" and make it obvious that additional help was needed. While this was "rare", when this occurred, they would provide the client with one of the 800 numbers mentioned above.

The discussions with clients do not include substantial educational content or a counseling component. Their primary focus appears to be helping debtors with the "sale" of debt management plans, rather than the provision of substantial education to their clients. Therefore, in evaluating their counseling sessions, we believe this is a strong factor showing ORG does not provide financial counseling as its primary activity.

COUNSELOR EDUCATION & TRAINING

In order for counselors to be able to properly educate and counsel clients, they need extensive training. Counselors should receive comprehensive training in counseling skills, personal finance, budgeting, and credit and debt management in live or interactive training sessions and through detailed written manuals. Counselors should also receive training on how to develop options and recommendations that address the particular circumstances of each client.

If ORG chose to do so, the people they hired could have already have received the above training. However, that is not the case here. As stated above, NN testified that the criteria for hiring was simply that the people have phone skills and could be empathetic to a person in debt. The new hires generally had either customer service or call centers experience, but nothing else was required. With a complete lack of required education or experience in financial counseling before a person is hired by ORG, ORG would have to train them to be counselors.

The educational process of the counselors was explained by the President during interviews, although documents to support when, where, and how the process occurred was not provided. Specifically, ORG does not have a written plan to confirm the process, timing, and precise methods used, by which all employees would be trained.

However, NN did testify that newly hired counselors were hired for a x day probationary

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period. This started with approximately x weeks of on-the-job training. This consisted of a classroom setting for the first week and then role playing the second week.

The remainder of the x day period was spent on the phones where they were provided some of the unproductive leads or other low priority callback calls, with the ability to put callers on hold and get direct support from more experienced employees, as needed. This x-day period was used to ensure that they had a quality employee and that they could be depended on to remain with the company for some time. Since the TO training was costly, they would not train the employee with the TO course until after the probationary period.

The TO course was completed during work hours at ORG. ORG provided a bound manual which was used to train for the TO certification. The x counselors were unable to agree on how much time they spent studying for this certification.¹⁶ After they completed the course, they then went to a local college to take the test to get their certification.

One counselor, who was asked for more specifics about the training, indicated the students would read the manual sections at home, and bring questions to the classroom training at ORG to learn about the materials. He explained this in a manner that indicated this was an interactive class with student participation.

As stated earlier, the two current employees went through their training together. Although they were not hired at the same time, one was hired around Sept. 200X and the other around June 200X, they received the training together as it would have been the first time ORG paid to get their employees certified.

ORG provided a copy of one employee's certificate; indicating she was a Certified Credit Counselor as of June x, 200X. This specific counselor had been employed almost x years before getting this certification. The certification is valid for x years and expired on June x, 200X. Since their two current counselors were certified at the same time, neither has a currently valid certification. ORG provided no information to show that the certification would be renewed.

The TO course materials used to certify their employees were reviewed in detail. Overall, the manual provides general training in communications skills, problem solving skills, and the credit and debt management industries. The personal finance and budgeting information is limited to x pages of information and therefore is very basic. The training also makes the assumption that a DMP is part of the solution for every debtor, if they qualify. In this respect,

¹⁶ As we stated before, ORG did not maintain procedures or other documentation that could be used to confirm which of the two was correct.

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there is some degree of marketing involved in that they are trying to get the clients to agree to or decide that they want to get on a DMP. While the manual acknowledges qualifying for and assumes the establishment of DMPs, the manual contains no such specific training for those purposes.

We believe the TO training course and certification is completely inadequate in personal finance, budgeting, or any training on how to develop options and recommendations that address the particular circumstances of each client.

As stated before, the TO training contains no specific training on the establishment of DMPs. This training would have come during the first week of training and the only documentation provided for this was the PRO training manuals and the various other training and guidelines discussed in the fact section. None of this training contains any specific training on personal finance, budgeting, or training on the development of options and recommendations for any particular financial circumstances.

Therefore, in reviewing all the training provided to ORG employees, they do not get trained in any type of counseling skills, personal finance, or budgeting tactics to help educate consumers. They are not trained to develop options or recommendations that specifically or generally address any of the circumstances that any of the ORG clients may be experiencing.

Furthermore, none of the ORG employees are trained to identify underlying personal problems that might contribute to financial problems. In fact, these appear to be almost taboo subjects and are not talked about unless the clients bring this information forward of their own volition.

In summarizing the ORG employees training and education, ORG does not require that the people they hire have any education specifically in providing financial education. They also do not require that they have work experience in providing financial education. ORG then trains them primarily in customer service and to qualify and sign people up for DMPs, in hopes of getting the person out of debt.

ORG employees therefore, do not have the abilities required to actually provide financial counseling to clients. Therefore, in evaluating their educational and experience requirements and the training provided to their employees, we believe this is a strong factor showing ORG does not provide financial counseling as its primary activity.

Another element of training and education that can be used as an indicator of an organization's purpose is how the employees are evaluated. In this case, the "numbers" produced by counselors is the single most important part of the ORG Employees evaluations. Also, the

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most important statistic used and discussed in the evaluations was the average number of payments. To clarify, this is not the number of clients put on a DMP; instead it equates to the number of DMP clients who actually made the "voluntary" initial contribution.

While the CEO indicates that it is much easier to evaluate a counselor based on numbers than subjectively on how well they counseled a client, the fact remains that the single most important item evaluated was the number of DMP clients who actually made the "voluntary" initial contribution. There was no mention in the evaluations of the counselors developing or presenting options to meet the clients' needs or tailoring solutions to clients' particular circumstances.

The evaluations were used to provide almost negligible bonuses to the employees, but more importantly they were used to determine raises and promotions for the employees. Therefore, the ORG employees are compensated, in part, based on the "voluntary" payments made by ORG DMP clients.

Also, the primary concern ORG had with employees, per the evaluations, is the income the employees earn for ORG, and not anything remotely related to education of the clients.

Outreach and Advertising

Other factors that should be considered to determine if ORG is primarily conducting exempt activities are their outreach and their advertising. The reason this needs to be considered is whether or not these are done primarily to bring in potential DMP customers, or whether they emphasize the educational aspects of the organization. This will provide an indication of its true primary purpose.

For this discussion, we need to consider their website, any mass media advertising, and direct mailings made to advertise ORG and whether they primarily discuss the educational aspects of the organization or whether they mainly discuss the DMPs.

In this case, ORG does not use mass media or direct mail in its operations. However, they do have a website.

Every website starts with the homepage. Throughout the homepage and the pages linked directly to the homepage, the website discusses and promotes the DMP. These pages repeat sales pitches, such as claiming to have "the most beneficial program in the industry", and the benefits of the DMP (lower payments, lower interest rates, etc.). All of these pages are directly or indirectly related to the DMP. While the website contained some static

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informational items that are generic in nature; they are difficult to get to. Education is not a substantial purpose of the website. It is primarily used to inform people about ORG DMP, to encourage them to sign up for it or to contact ORG specifically to get on a DMP, and to give them helpful advice for when they have already signed up for the DMP.

Although, the website indicates there are a few different "payment programs", it does not indicate what the payment options are. In fact, the DMP is the only solution promoted by the website.

Instead of using mass media or direct mail, ORG primary source of potential clients has always been purchased leads, in fact this has been almost their sole source of potential clients. They do not regularly receive referrals from employers, union leaders, clergymen, community organizations or creditors. ORG indicated that they would receive an occasional referral from a current customer or from their website, although no records were kept to determine the numbers of these referrals.

Governance

Another factor to be considered, in determining if an organization is primarily conducting exempt activities, is how the organization is governed. We will need to decide whether the board is independent and community-based or whether it is a small, related board or a board dominated by creditors or others with financial interests in the organization. This will give an indication as to whether the board is looking after the welfare of the public the organization is supposed to be educating vs. persons with financial interests in the operations of the organization.

Based on the bylaws, ORG started with only x board members, NN and NN and NN. In 200X, NN resigned and NN and NN became Directors. Near the end of 200X NN was elected as the xth director.

Besides NN, there are x TITs on the board (one is NN's brother-in-law), a co-worker of NN's at UR, and another business associate in the leasing industry. This is a small board of family, associates, and acquaintances of NN family members. None of the board members have any particular experience in counseling, finances, or education.

Based on information in the board minutes, NN may have undue influence over the board, as illustrated by the following. The board meets¹⁷ only once per year. Starting with the 200X minutes, NN was authorized a salary of \$x per year. In the July x, 200X minutes, NN

¹⁷ In person or by phone.

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suggested the level of compensation in the corporation remain steady for the upcoming year. At the October x, 200X meeting, after a review and discussion of one sheet of data with essentially x lines of x year old data on it, the board approved a salary at \$x. In 200X, there is no record of an actual meeting, but in lieu of a meeting, the board members signed a written consent, all on separate pieces of paper, that the \$x raise approved in Oct. of 200X, would be retroactive to Jan. x, 200X. The next meeting held in 200X, left his salary untouched and a month later, ORG filed for bankruptcy protection.

Another factor to consider is the topics of discussion and the board involvement with the claimed exempt purpose of ORG, education and counseling. The board received its first documented presentations from NN in 200X. While education and counseling were not mentioned, state regulation of the DMPs was. In the 200X presentation, NN mentions the ISO certification and efforts to certify counselors with x months of experience. These x items are becoming standard in the industry and are regularly required by creditors to obtain fairshare payments. In 200X, no board meeting was documented, other than the written consent previously mentioned concerning NN's compensation.

In 200X, after the Credit Counseling Industry had been put under the proverbial microscope, the board finally discussed the educational content of both the website and the service. However, the phone conference meeting lasted x minutes and they also discussed the state of the industry, regulation bodies, reduction in fairshare, the declining age base of their clients, the ORG 401K plan, and salaries not changing due to the current business climate. Out of x years of annual board meetings, this is an extremely small amount of time spent on what is supposed to be the exempt purpose of the entity.

In summary, we find that the board is a small board composed of relatives, close associates and close acquaintances of x family members with almost no experience in counseling, finances, or education. The minutes also suggest that NN has undue influence over the board and ORG. The board minutes indicate they are much more interested and concerned in operating the DMP and the income and expenses related to those operations than they are about educating ORG clients. Therefore, we find that the governance of ORG, in composition and in their actions, is a factor highly in favor of ORG not operating primarily to further education within the meaning of 501(c)(3).

Funding Sources

In analyzing funding sources, we are trying to determine whether the sources of funding compromise the independence of the organization or compromise its focus on education and the needs of the clients.

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ORG income comes from fairshare payments and funds, which ORG labels as "voluntary contributions" that are received in exchange for DMP services. NN estimated that x of x% of ORG clients did not pay these "voluntary contributions". ORG fairshare is received from entities with a financial interest from the organization¹⁸, and for which conditions are placed on the receipt of funding.

The flip side of having almost all of their funding coming from DMPs, in fees and fairshare, means they receive very little in the form of contributions, in this case, absolutely nothing. ORG receives no government grants or donations from private foundations. They receive no donations from community groups, churches, labor unions, or any other groups or private citizens. Furthermore, they do not seek any type of donations.

The credit counseling organizations that were found to be exempt, including those in Rev. Rul. 69-441 and 65-299 (and remember this one is a 501(c)(4)), and in both the CCCS of Alabama and CCCS of Oklahoma, as well as the numerous rulings where individual (non-credit) counseling is provided for free, the organizations were all supported by contributions from the public.

For-profit business enterprises are supported by fees paid by those who receive services. While charitable institutions often do provide services to individuals, the cost is generally subsidized by contributors who do not receive anything in return. In B.S.W. Group, Inc. v. Commissioner, supra, the court cited lack of solicitation and sole support from fees as negative factors for exemption. See also, Easter House v. United States, supra.

Due to those three reasons, we believe ORG funding sources are clearly indicative of a for-profit operation and not those of an exempt organization. Therefore, in evaluating their funding sources, we believe this is a strong factor showing ORG primary activity is the selling of DMPs in a for-profit business venture. It is not consistent with an organization that is providing free counseling as its primary activity.

(C) Summary of Analysis – Issue 1 Do ORG primary activities accomplish an exempt purpose?

Since substantially all of ORG revenue and expenditures and employee workforce hours related directly to their call center and DMP operation, this is their primary activity. We have established that their counselors ask only enough financial information to pre-qualify callers into the DMP. The counselors do not discuss budgeting and finances, except to collect this

¹⁸ The financial interest is the debt collected for them by ORG.

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information for DMP purposes. They do not discuss employment, education, buying habits, significant future changes in finances, assets, or secured debt in any meaningful manner. The counselors do not develop options or strategies tailored to the needs of clients, and therefore are unable to discuss the advantages or disadvantages of those options. The only option at their disposal to help clients is a DMP. Furthermore, they are not trained to probe for or recognize other potential causes of debt that should be referred to other appropriate social services or programs that may be needed by clients.

Before they are hired, ORG employees are not required to have education or experience in providing financial education. While the ORG employees are trained on customer service and DMPs, they are not trained in subjects that would allow them to provide financial education. They are not trained to identify the causes of an individual's debt or other personal problems that may contribute to the situation. Additionally, counselors are not evaluated on how thoroughly and effectively they develop and present options to match the particular circumstances of any client. While they are not compensated based solely on DMPs, they are, in part, compensated based on the amounts ORG earns from paying DMP clients.

While ORG does not use mass media or direct mail to advertise its DMPs to the general public, ORG almost exclusive source of clients is through purchased leads. Also, based on ORG prominence and the importance placed on DMPs, their internet website is primarily focused on the sale of DMPs.

Our review of ORG governance shows the board of directors is not an independent community-based board, but a small board that is unduly influenced by the CEO. In operation the board's primary focus was the DMP and the income and expenses associated with the DMP. Overall, the board was motivated by profit and rarely considered their stated exempt purpose of providing education to the public.

ORG funding sources establish that substantially all of their income relates to their enrollment of DMP clients. They receive no charitable contributions and have no aspirations of attracting charitable funding.

Therefore, we find that it is clear from our audit and review of the available information that every single factor analyzed using the Core Analysis tool indicates that ORG operations are not educational. This fact pattern shows a clear and decisive difference between ORG operations and those organizations that have been determined to be exempt in the past. Therefore, ORG does not meet the operational test required by Section 1.501(c)(3)-1(a)(1) of the Regulations.

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(D) Issue 2 – Are more than an insubstantial part of ORG activities are in furtherance of a non-exempt purpose?

Operating in a Commercial Manner

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.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in *Better Business Bureau of Washington D.C. Inc. vs. United States*, supra, the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if we agreed that they were organized and operated for an exempt purpose, the fact that they also have a substantial non-exempt purpose would be sufficient to deny recognition to them. Specifically, the court in *Better Business Bureau* held that if education is conducted for a non-exempt purpose, the organization will not be recognized as exempt. Based on all the facts and circumstances of ORG, its operation of debt management plans is so pervasive that its activity of providing DMPs demonstrates that they operate in a commercial manner.

No court or IRS ruling has indicated that the sale of debt management plans is a charitable activity. Since the sale of these services to the general public has been established to be one of their substantial purposes, in fact their primary purpose, we cannot conclude that they are operating for charitable purposes.

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

Any activities involving "authentic" credit counseling provided to a genuine charitable class or the provision of credit education to the general public, would be purely incidental to their predominant non-exempt purpose of operating and carrying-on an ordinary for-profit debt management business. Since we have previously determined their call center and DMP operations are not educational, we are unable to say that those operations are in furtherance of an exempt purpose.

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In addition, their organization shows none of the public involvement that characterizes organizations serving a public interest. Their activities are carried out by paid employees rather than volunteers.

Their board is very small and composed of NN, his brother-in-law, and family associates. Their board members are unlike the organization described in *Rev. Rul 69-441, supra*, in which the organization's Board of Directors is comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions. As was stated previously, the board is mostly concerned with the profits from its DMP operations and all but ignored education as a topic of discussion. ORG is operated in a commercial, rather than a charitable manner.

Similar to the organization in Easter House, which operated an adoption agency, we have found that their organization is operated for a substantial commercial purpose rather than for the exempt purposes of providing educational and charitable services to the portion of the public they serve. Their almost non-existent educational activities are merely provided "incident" to their operations related to DMPs. Their funding is also similar to that of Easter House. They are completely funded by fees related to their DMP operations and seek no funds from federal, state or local sources, nor engaged in fund raising programs, and do not solicit contributions. Also like Easter House, no court has found their services in and of themselves to constitute an exempt purpose.

Similar to Airlie Foundation, we believe they would fail the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which they conduct activities, we believe they are operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. Their exclusive use of purchased leads to obtain potential DMP clients, their efficient pre-qualification process, their emphasis on and evaluation of their employees in obtaining paid clients, their board's emphasis on DMPs and profits, their concern about ex-employees competing against them or for their competitors, as well as other factors allow us to conclude they have a substantial commercial purpose.

Avoidance of CROA

We believe their situation is also similar to FTC V. Gill. We believe a substantial purpose of the organization obtaining exempt status was to avoid regulation under CROA. Since, ORG charged initial fees which resulted in millions in revenue, which would be prohibited under CROA, they had a substantial motive to avoid the CROA regulations.

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Therefore, we believe that a substantial purpose of obtaining its exempt status was to avoid regulation by CROA; a substantial non-exempt purpose.

(E) Summary of Analysis – Issue 2 – Are more than an insubstantial part of ORG activities are in furtherance of a non-exempt purpose?

In issue 1 above, we determined that ORG primary activity consisted of the non-exempt activity of singing up individuals for DMPs, and that this was done without a substantial educational component. This same argument could be used here, to say that more than an insubstantial part of ORG activities are in furtherance of a non-exempt purpose.

Additionally, we conclude that ORG is operated for substantial non-exempt purposes. We believe that their operations are of a commercial, profit-motivated DMP program, having numerous indicia of for-profit businesses and no indicia of an exempt organization. We also believe they obtained their exempt status to avoid the regulations of CROA.

We believe that each of the above aspects is a substantial non-exempt purpose, each of which preclude their organization from being regarded as “operated exclusively” for one or more exempt purposes within the meaning of Section 1.501(c)(3)-1(c)(1) of the Regulations.

Taxpayers Position:

ORG has yet to provide a reasoned, documented response to conclude they were operated in an exempt manner.

However, in addressing just the Core Analysis Tool analysis they stated, “The overall assessment is correct, I do however feel that the amount of help and advice that our counselors provide including information on options and the various paths to gain debt relief have been lost in the presentation”.

Conclusion:

The early operations of ORG followed some fairly abusive credit counseling agency’s business models. This included charging a full months payment as the set-up fee. Numerous government agencies have alleged that this can be abusive and harmful to the debtors, and in many cases was illegal based on various state laws. This was done before the audit period in question.

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However, ORG changed its operations to meet the various state requirements. In doing so, they may have actually helped many of the debtors they placed on DMPs to get out of debt, although this too is undocumented. As we have stated before, helping a non-charitable class get out of debt is not an exempt activity.

ORG statement that we did not properly consider or that we too easily dismissed the advice, options, and various paths provided to gain debt relief are statements that are not supported by the documentation provided by ORG. ORG has maintained no documentation of their actual operations that suggests that they have any meaningful factors or characteristics of an exempt educational credit counseling operation.

Based on the examination of their activities in light of the applicable law, we find they are not operated for exempt purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes of such section. If an organization fails to meet either the organizational and operational test, it is not exempt. Their organization has failed to meet the operational test since they function for the intake and servicing of debt management plans. This is their primary activity, which is non-charitable. This activity does not accomplish an exempt purpose, which in this case should be to provide education and financial counseling. Further, their debt management activities are not an integral part of providing education or financial counseling.

We have also determined they are operated for numerous substantial non-exempt purposes, including operating a commercial for profit business and operating to avoid regulation by CROA. As these are substantial non-exempt purposes, their organization is precluded from being regarded as "operated exclusively" for one or more exempt purposes within the meaning of Section 1.501(c)(3)-1(c)(1) of the Regulations.

Therefore, for the reasons stated above, ORG exempt status should be revoked from the inception of its existence.