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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201121021**
Release Date: 5/27/2011
Date: March 3, 2011
Uniform Issue List
501.00-00

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose,* and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: December 01, 2010

Uniform Issue List
501.00-00

Legend:

HC	=
Related LLC	=
Consulting Firm	=
State	=
Date 1	=

Dear

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

Facts

You, doing business as HC, are an organization that provides foreclosure related services. You were incorporated on Date 1 as a nonprofit corporation under State law. Your Articles of Incorporation ("Articles") state that your specific purpose is to:

> . . . [P]rovide educational services to homeowners in default on their mortgages. Work in conjunction with mortgage holders, insurers and investors to assist homeowners in default and identifying appropriate resolution options.

According to your bylaws, you will do business as HC. Your bylaws state that you are organized to:

> . . . [A]ssist homeowners in default on their mortgages find a way if possible to retain ownership of their homes. Our activities are centered around borrower contact, financial analysis, counseling of borrowers with budgeting and responsible handling of their

obligations as well as working with the mortgage company to develop a solution that will allow the homeowner to be successful.

You are governed by two directors, both of whom are also officers. One director is your president, treasurer, and chairman of the board. The other director is your vice-president and secretary. You also refer to these two directors as co-presidents. Your two directors are also owners and directors of a for-profit corporation, Related LLC, an organization with which you share employees, a website, and office space. Related LLC is a State limited liability company formed to "provide counseling services to borrowers." Related LLC also provides consulting services to lenders. You stated that "[t]he organizations have common owners and governing body members," and provide similar services. One of your directors also owns Consulting Firm, a consulting firm that provides assistance to law firms performing legal work for mortgage servicers. You indicated that Consulting Firm "may provide leads or introductions for the counseling services being offered." However, you stated that, currently, you do not receive referrals or have plans to purchase leads from any source.

You provide consulting services to lenders and "investors." You explain that investors are those organizations or individuals who have purchased the loan being serviced by the mortgage company. These services include contacting the borrower in person, over the phone, or by letter; collecting financial information from the borrower; recommending resolutions; gathering documentation; and monitoring the borrower's performance. The amount you charge for these services is based on the services provided, the volume from the servicer, and the range of services the loan servicer wants performed. In certain circumstances, you also receive fees from the mortgage company that are paid by the investor for resolving the loans without foreclosure.

You serve as a "loss mitigation representative" for homeowners. In this role you work with mortgage lenders and other service providers to help your client secure a "workout plan" with the lender and avoid foreclosure. This requires you to submit financial documents and other required documents on behalf of your client. You stated that the "broader credit counseling initiatives are left to professionals better suited to address those issues."

You also provide other mortgage mitigation services, which generally include pursuing the following options on behalf of your clients: forbearance, modification, short sale, or deed-in-lieu of foreclosure.

You stated that your "current fee structure charges $395 up front to review the financial information, provide a recommendation and submit the recommendation to the mortgage company with back up." However, you indicated that "[a]n additional $300 is charged at the time the package is submitted to the mortgage company." You indicated that clients are eligible for a reduced fee based on their financial ability to pay; yet, despite our request, you did not indicate how you will determine who is eligible for a reduced fee or how you will determine the amount of the fee reduction.

You provided a consulting agreement ("Consulting Agreement") that refers to you as a State limited liability company. The Consulting Agreement indicates that you provide services in three phases, Phase 1, Phase 2, and Phase 3, and identifies the fees charged for each phase.

> Phase 1. As part of Phase 1, you: "[m]eet with Homeowner and discuss loss mitigation opinions, foreclosure process, documents needed to proceed" and send the homeowner an application package. There is no cost for Phase 1.
>
> Phase 2. As part of Phase 2, you "[o]btain information from Homeowner regarding Homeowner's financial condition, credit status, valuation of the [mortgaged property] and status of mortgages against the [real property] . . . ." After receiving this information you analyze alternatives and discuss with the homeowner. Phase 2 services cost $395.
>
> Phase 3. As part of Phase 3, you prepare and submit to the lender a report of the Homeowner's financial condition and other information provided by the Homeowner (e.g., a hardship letter, pay stubs, and a letter of authorization) and you follow-up with the lender to discuss alternatives until resolution to the mutual satisfaction of the lender and the Homeowner or you determine that a resolution is not reasonably possible. Phase 3 services cost $300.

In regard to the amount of the fees charged for the services you perform, you indicated that the fees are standard for the services provided "with a review fee and a resolution fee based on successfully obtaining a resolution from the mortgage company." However, the Consulting Agreement states that you are entitled to the fee when you determine that a resolution is "not reasonably possible" and provides that your "fee shall be due whether or not a successful outcome is achieved. . . ."

The Consulting Agreement also indicates that you "may seek fees (in addition to the compensation due from Homeowner as above provided) from Homeowner's lender or others involved in resolving Homeowner's financial obligations," provided such fees "neither compromise [your] ability to represent Homeowner's interests nor increase the cost of any agreed-upon resolution."

In response to our request to provide details of your educational program, you stated:

> Educational sessions do include a one on one discussion with homeowners as well as those opportunities when I have been invited to speak to groups of people about the services we provide. We have held workshops in conjunction with the realtor community, have participated in a radio show hosted by a church group as well as presenting at various industry meetings.

You stated that your "services provide education to the borrower regarding their financial obligations and work to insure that the housing obligation remains a primary obligation. Our objective is to assist them in making the choices that are required in order for them to retain ownership of their home."

In response to the question "[s]ince you have indicated that your employees are clerical, who will be providing the educational aspects of your program and who will be negotiating with lenders?" you responded "[t]raining is provided at time of hiring. All employees have prior experience in the mortgage industry and have a basic understanding of assisting clients." You did not identify what training is provided at the time of hiring. You did not budget any money for training or educational activities.

You represent that you will not limit your services to a particular class of people, such as minorities, low-income individuals, or the elderly. "Everyone is eligible for a review of their financial information." However, "[w]e can not [sic] assist everyone either due to the programs that are currently available or based on the borrower's financial condition." You did not elaborate further as to why or when the borrower's financial condition prevents you from providing consulting services.

You provided a Client Input Questionnaire (hereinafter referred to as "intake sheet") that provides lines for the borrower's name, address, and phone number, as well as lines to identify their hardship, desire to liquidate or keep their home, and their mortgage company, balance, and payment. You also provided a financial worksheet that has input boxes for items of income and monthly expenses.

You indicated that you will follow the same strategy utilized by Related LLC to attract clients. This strategy includes building relationships with realtors, bankruptcy attorneys, and others who have referred clients, as well as marketing to various organizations whose members may need your services. You will also market "to mortgage servicers to assist them directly or get referrals from them in order to assist the most number of people possible."

You indicated that you will undertake fundraising and solicit government grants. However, you did not provide a description of any fundraising programs. You did not indicate that you have received any government grants or contributions from individuals.

You indicated that you share office space and employees with Related LLC. You provided a lease agreement ("Lease Agreement") that you are "operating within." The Lease Agreement was entered into between the lessor and Related LLC as lessee. The Lease Agreement lists your previous address as the defined "premises" and provides for a monthly rent of $ The annual rent due under the Lease Agreement is $ Your application indicates that you have projected occupancy expenses of $ in 20 and 20 You informed us by letter dated March 9, 20 that your address has since changed. You submitted the lease Related LLC entered into to at your new address. You also submitted a sublease agreement ("Sublease") entered into with Related LLC. The Sublease lists you as the subtenant and Related LLC as the sublessor. However, the term of the Sublease is not scheduled to begin until after the term of the Sublease is scheduled to end. The director that signed the Sublease on your behalf also signed on behalf of Related LLC. You represented on your application for exemption that you would not enter into any leases, contracts, loans, or other agreements with any organization in which either of your directors are also officers, directors, or trustees.

You and Related LLC have an identical board of directors. You share a website with Related LLC. You responded to our questions on Related LLC letterhead. The Consulting Agreement you provided refers to Related LLC. In response to our question regarding how your operations differ from Related LLC, you stated that the objectives are the same, but you were set up to "take advantage of the opportunities that are not available to for profit entities." Presumably, these opportunities include the ability to apply for grants and to become a certified U.S. Department of Housing and Urban Development (HUD) counselor. You also stated that your requirements may be different from Related LLC. You stated that you will keep clients separate from Related LLC, but did not indicate how this would occur.

You share two staff members, who "do a combination of administration and counseling work" with Related LLC. Their primary responsibilities are "to work with the mortgage company to resolve the delinquency and help the homeowner." Their duties include customer contact, clerical support, compiling and submitting financial packages to the mortgage companies, and following up with the mortgage companies until resolution. The two employees earn $10-14 an hour based on experience.

Your application indicates that you will pay both directors the same amount. This amount is based on anticipated revenues, industry levels, and experience. Your directors' aggregate fixed compensation exceeds 50% of your projected revenues. You also intend to pay discretionary bonuses and other non-fixed compensation "based on the results of the business." Your directors are responsible for determining how much to pay themselves in salary and bonuses.

You have a conflict of interest policy ("COI"). You provided no evidence to show that the COI was executed by your governing body. The COI defines an "interested person" as "[a]ny director, principal officer or member of a committee with governing board delegated powers, who has a direct or indirect financial interest. . . ." "Financial interest" is defined to include a direct or indirect ownership or investment interest in any entity in which you have a transaction or arrangement, a compensation arrangement with you or any other entity or individual with which you have a transaction or arrangement, and a potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which you are negotiating a transaction or arrangement. The COI provides for a duty to disclose actual or possible conflicts of interest. After disclosure, the person with the conflict must leave the governing board or committee meeting while the remaining board decides if a conflict of interest exists. The COI does not discuss procedures for addressing situations where both directors have a duty to disclose a "financial interest."

You plan to enter into joint ventures, including partnerships or limited liability companies treated as partnerships, in which you share profits and losses with partners other than section 501(c)(3) organizations. You stated that joint ventures may include providing consulting services for "mortgage companies, private investors of loans or others where review of process or assisting with the resolution of loans is of primary importance." You may also enter into a joint venture with a licensed real estate broker to assist your clients with required real estate transactions.

Law

Section 501(a) of the Code provides that an organization described in section 501(c) shall be exempt from federal income taxation.

In order to be described in section 501(c)(3) of the Code a corporation must be organized and operated exclusively for charitable or educational purposes and no part of its net earnings may inure to the benefit of any private shareholder or individual.

Section 501(q) of the Code provides that organizations which provide "credit counseling services" as a substantial purpose shall not be exempt from taxation under section 501(a)

unless they are described in sections 501(c)(3) or 501(c)(4) and they are organized and operated in accordance with the following requirements:

(A) The organization--

(i) provides credit counseling services tailored to the specific needs and circumstances of consumers,

(ii) makes no loans to debtors (other than loans with no fees or interest) and does not negotiate the making of loans on behalf of debtors,

(iii) provides services for the purpose of improving a consumer's credit record, credit history, or credit rating only to the extent that such services are incidental to providing credit counseling services, and

(iv) does not charge any separately stated fee for services for the purpose of improving any consumer's credit record, credit history, or credit rating.

(B) The organization does not refuse to provide credit counseling services to a consumer due to the inability of the consumer to pay, the ineligibility of the consumer for debt management plan enrollment, or the unwillingness of the consumer to enroll in a debt management plan.

(C) The organization establishes and implements a fee policy which--

(i) requires that any fees charged to a consumer for services are reasonable,

(ii) allows for the waiver of fees if the consumer is unable to pay, and

(iii) except to the extent allowed by State law, prohibits charging any fee based in whole or in part on a percentage of the consumer's debt, the consumer's payments to be made pursuant to a debt management plan, or the projected or actual savings to the consumer resulting from enrolling in a debt management plan.

(D) At all times the organization has a board of directors or other governing body--

(i) which is controlled by persons who represent the broad interests of the public, such as public officials acting in their capacities as such, persons having special knowledge or expertise in credit or financial education, and community leaders,

(ii) not more than 20 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the repayment of consumer debt to creditors other than the credit counseling organization or its affiliates), and

(iii) not more than 49 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees).

. . .

(F) The organization receives no amount for providing referrals to others for debt management plan services, and pays no amount to others for obtaining referrals of consumers.

Section 501(q)(2)(A)(i) of the Code provides that if an organization is described in section 501(c)(3) and is providing credit counseling services as a substantial purpose, it may be exempted from tax only if it does not solicit contributions from consumers during the initial counseling process or while the consumer is receiving services from the organization.

Section 501(q)(2)(A)(ii) of the Code provides that if an organization is described in section 501(c)(3) and is providing credit counseling services as a substantial purpose, it may be exempted from tax only if its aggregate revenues from payments by creditors of consumers of the organization attributable to debt management plan services do not exceed a specified percentage of total revenues.

Section 501(q)(4)(A) of the Code defines, for purposes of section 501(q), the term "credit counseling services" to mean (i) the providing of educational information to the general public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of consumer credit; (ii) the assisting of individuals and families with financial problems by providing them with counseling; or (iii) a combination of the activities described above.

Section 501(q)(4)(B) of the Code defines, for purposes of section 501(q), the term "debt management plan services" to mean services related to the repayment, consolidation, or restructuring of a consumer's debt, and to include the negotiation with creditors of lower interest rates, the waiver or reduction of fees, and the marketing and processing of debt management plans.

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

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

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

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose, either by an express provision in its governing instrument or by operation of law.

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) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) of the regulations defines the words "private shareholder or individual" in section 501 of the Code to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and, specifically, that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and includes the relief of the poor and distressed or of the underprivileged.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations provides that the term "educational," as used in section 501(c)(3) of the Code, relates to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

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

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling and, if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, holding the funds in a trust account and disbursing the funds on a partial payment basis to the creditors. The organization did not

charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid. The organization did not make loans to debtors or negotiate loans on their behalf. Finally, the organization relied upon contributions, primarily from the creditors participating in the organization's budget plans, for its support. Creditors were not required, though, to make such contributions as a condition of participation.

The Service found that, by aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and beneficial to the community. Thus, the organization was exempt from federal income tax under section 501(c)(3) of the Code.

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (individual and group counseling of widows, where fees charged for services were based on ability of the widow to pay); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 178 (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 (personal marriage counseling and public seminars supported by area churches, clients' fees, and contributions); 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 or below-cost, and the organizations were supported by contributions from the public.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283, 66 S. Ct. 112, 90 L. Ed. 67 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services did not satisfy the operational test under section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of typical section 501(c)(3) organizations. 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, while to some extent the fees charged reflected ability to pay, 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 Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978), the court held that an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational.

The Consumer Credit Counseling Service of Alabama was an umbrella organization made up of numerous credit counseling service agencies. These agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they did provide such services free of charge. As an adjunct to the counseling function, they offered a debt management plan. Approximately 12 percent of a professional counselor's time was applied to the debt management plan as opposed to education. The agencies charged a nominal fee of up to $10 per month for the debt management plan. This fee was waived in instances when payment of the fee would work a financial hardship.

The 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. As such, the community and education counseling assistance programs were the agencies' primary activities. 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. An incidental amount of their revenue was from service fees. Thus, the court concluded that "each of the plaintiff consumer credit counseling agencies was an organization described in section 501(c)(3) as a charitable and educational organization." *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 were virtually identical and the law was identical to those in Consumer Credit Counseling Service of Alabama, Inc. v. United States, discussed immediately above.

In People of God Community v. Commissioner, 75 T.C. 127 (1980), the court found that part of an organization's net earnings inured to the benefit of private individuals because their compensation was based on a percentage of the organization's gross receipts with no upper limit. The court held that the petitioner was not exempt as an organization described in section 501(c)(3) of the Internal Revenue Code of 1954.

In Easter House v. United States, 12 Cl. Ct. 476 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988) cert. denied, 488 U.S. 907, 109 S. Ct. 257, 102 L. Ed. 2d 246 (1988), the court found an organization that operated an adoption agency was not described in section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. The court concluded that its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court found that the health-related services provided to unwed mothers and their children were merely incidental to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3).

In Orange County Agricultural Society, Inc. v. Commissioner, 893 F.2d 529 (2d Cir. 1990), the Court of Appeals for the Second Circuit affirmed the Tax Court's holding that loans extended by a section 501(c)(3) organization on advantageous terms to its founders, or to an entity controlled by them, indicate private inurement and justify revocation of its tax-exempt status. The exempt organization made several interest-free loans, without obtaining any written security. While some payments were made, the repayments did not match the loan amounts and the total amount loaned exceeded the total amount repaid. Moreover, there was no evidence in the record that the full amount loaned would ever be repaid.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the Court of Appeals for the Seventh Circuit upheld a Tax Court decision that an organization operating restaurants and health food stores in a manner consistent with the doctrines of the Seventh Day Adventist Church was not described in section 501(c)(3) of the Code because the organization was operated for a substantial nonexempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in competition with other restaurants, engaged in marketing, and generally operated in a manner similar to commercial businesses.

In Housing Pioneers v. Commissioner, 58 F.3d 401 (9th Cir. 1995), the Court of Appeals for the Ninth Circuit upheld the two grounds on which the Tax Court denied exemption under section 501(c)(3) of the Code to an organization that provided low-income housing in view of evidence (1) of a substantial nonexempt purpose of providing the benefit of state and federal low income housing credits to its for-profit partners, and (2) that in carrying out this nonexempt purpose, the benefits inured in part to private individuals. The applicant organization would form partnerships in which the other partners, including partnerships that were not exclusively charitable, would benefit from the property tax exemption obtained under California law as a result of the non-profit's participation. Part of the property tax savings would be retained by the partnership and used to keep the rents low, and part of the savings would be paid to the applicant non-profit and used to further its charitable purposes. As such, an arrangement that takes advantage of an exempt organization's funds or its exempt status to benefit insiders is prohibited even if the arrangement benefits the non-profit as well.

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 nonexempt commercial purpose, rather than for an exempt purpose. As the court stated:

> Among the major factors courts have considered in assessing commerciality are competition with for profit 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.

In Solution Plus, Inc. v. Commissioner, T.C. Memo. 2008-21, the Tax Court held that a credit counseling organization was not described in section 501(c)(3) because it was not organized and operated exclusively for educational or charitable purposes and impermissibly served private interests. The organization was formed by an individual with experience selling

debt management plans ("DMPs"). The founder and his spouse were the only members of the organization's board of directors. The organization did not have any meaningful educational program or materials to provide to people who contacted the organization, and its financial education seminars for students constituted an insignificant part of the organization's overall activities.

The Court held that the organization's purposes were not educational because its "activities are primarily structured to market, determine eligibility for, and enroll individuals in DMPs." Its purposes were not to inform consumers "about understanding the cause of, and devising personal solutions to, consumers' financial problems," or "to consider the particular knowledge of individual callers about managing their personal finances." The Tax Court also held that the organization's purposes were not charitable because "its potential customers are not members of a [charitable] class that are benefited in a 'non-select manner' * * * because they will be turned away unless they meet the criteria of the participating creditors."

The Tax Court further held the organization would operate for the private interests of its founder because the founder and his spouse were the only directors, the founder was the only officer and employee, and his compensation was based in part on the organization's DMP sales activity levels. The organization was "a family-controlled business that he personally would run for financial gain, using his past professional experience marketing DMPs and managing a DMP call center." The Court further held that the organization's principal activity of providing DMP services, which were only provided if approved by a caller's creditors, furthered the benefit of the private interests of creditors as well.

Finally, the Tax Court held that the facts in Credit Counseling Services of Alabama v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978) "stand in stark contrast" because "the sale of DMPs is the primary reason for [Solution Plus's] existence, and its charitable and educational purposes are, at best, minimal."

Rationale

Section 501(c)(3) of the Code sets forth two main tests for an organization to be recognized as exempt. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). Section 1.501(c)(3)-1(a)(1) of the regulations. You fail both tests.

Organizational Test

To demonstrate that it is organized exclusively for exempt purposes, thus satisfying the organizational test, an organization must have a valid purpose clause. Section 1.501(c)(3)-1(b)(1)(i) of the regulations. A valid purpose clause limits the organization's purposes to one or more exempt purposes and does not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes. Section 1.501(c)(3)-1(b)(1)(i) of the regulations.

Your Articles provide that your specific purpose is to:

> [P]rovide educational services to homeowners in default on their mortgages. Work in conjunction with mortgage holders, insurers and investors to assist homeowners in default and identifying appropriate resolution options.

Your Articles do not limit your purposes to one or more exempt purposes. Specifically, this provision allows you to engage as a substantial part of your activities in the nonexempt purpose of providing commercial consulting services to mortgage holders, insurers, and investors to identify appropriate mortgage resolution options. Indeed, Related LLC, which is a for-profit corporation, has the same purpose. Because your Articles do not limit your purposes to one or more exempt purposes, you do not have a valid purpose clause. Therefore, you do not satisfy the organizational test.

Operational Test

To satisfy the operational test, an organization must establish that it is operated exclusively for one or more exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations. 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) of the Code. Section 1.501(c)(3)-1(c)(1) of the regulations. Under the operational test, the purpose towards which an organization's activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a section 501(c)(3) organization. B.S.W. Group, *supra*. Your activities are not directed toward one or more exempt purposes. While you engage in one-on-one discussions with homeowners and public presentations that may, in part, further educational or charitable purposes, your activities primarily further the substantial nonexempt purpose of selling financial services to homeowners and lenders for a fee. Thus, you have failed to establish that you are operated exclusively for one or more exempt purposes.

You Are Not Operated Exclusively for Educational Purposes

Your activities demonstrate that you do not operate exclusively for educational purposes within the meaning of section 501(c)(3) of the Code. You stated that your educational activities include a "one on one discussion" with homeowners regarding their financial obligations and the choices that are required for them to retain ownership of their home. Your methodology distinguishes you from the exempt organizations in Consumer Credit Counseling Service of Alabama, *supra,* and Rev. Rul. 69-441, *supra*. These exempt financial counseling organizations primarily informed the public on budgeting, buying practices, and the sound use of consumer credit. Any debt management programs were incidental to these primary educational activities. Unlike these exempt financial counseling organizations, you do not offer counseling sessions that are structured primarily to improve your clients' understanding of their financial problems or their skills in solving them. You provided no evidence that your employees do anything other than sit down with your clients to fill out the information that is needed to submit a statement of their financial condition to the lender. Your statement that all employees have "prior experience in the mortgage industry and have at least a basic understanding of assisting clients" does not demonstrate that your counselors are equipped to provide individually-tailored financial recommendations or do anything beyond merely relaying the mortgage company's offer. You

have not dedicated any revenue to activities involving educational programs for homeowners or the general public, or even to training your employees, and none of your employees have education, instruction, or training as a responsibility. Thus, you have not demonstrated that you engage in these discussions primarily to further an educational purpose.

While one of your officers has held workshops in conjunction with the realtor community, participated in a radio show hosted by a church group, and presented at various meetings, the material presented by your officer was focused on the services you provide. Thus, although these presentations offered some information to the public, they primarily served a promotional, rather than educational purpose. Even if these presentations had been solely educational in nature, they constitute an insignificant part of your overall activities.

Indeed, your operational focus is on generating fees from your consulting activities. Like the organization that failed to qualify for exemption in Solution Plus, *supra*, your efforts are focused on informing potential clients about the range of services available and signing them up for your services, rather than on conducting a meaningful educational program. You did not provide evidence that you help clients develop an understanding of the cause of their financial problems. You provided no evidence that you intend to establish long-term counseling relationships with your clients.

Therefore, you have failed to demonstrate that your interactions with clients and the community are designed to provide instruction or training "useful to the individual and beneficial to the community" within the meaning of section 1.501(c)(3)-1(d)(3)(i) of the regulations. Thus, you are not operated exclusively for educational purposes within the meaning of section 501(c)(3) of the Code.

You Are Not Operated Exclusively for Charitable Purposes

Your activities demonstrate that you do not operate exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. Most of your time and resources are devoted to providing financial services for a fee to commercial entities or to individuals who are not part of a charitable class.

You provide foreclosure consulting services to lenders and investors. Helping lenders and real estate investors avoid taking a loss or having to go through the foreclosure process does not provide relief to the poor and distressed within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations or serve any other purpose recognized as charitable.

You also provide foreclosure consulting services to individuals. You state that "[e]veryone is eligible for a review of their financial information." Therefore, your services are not directed exclusively to low-income individuals. Accordingly, you are unlike the organization described in Rev. Rul. 69-441, *supra*, which aided low-income individuals and families who have financial problems, thereby relieving the poor and distressed.

Moreover, you charge fees for the majority of your services. While you represented that homeowners are eligible for a reduced fee based on their financial ability to pay, you did not indicate, despite our request, how you will determine who is eligible for a reduced fee or the amount of the fee reduction. This distinguishes you from the exempt organizations in Consumer

Credit Counseling Service of Alabama; *supra*, and Rev. Rul. 69-441, *supra*, which relied upon contributions to provide their services for free or, at most, for only a nominal fee. Indeed, "primarily providing services for a fee ordinarily does not further charitable purposes." Solution Plus, *supra*.

Thus, you have failed to establish that your activities exclusively further charitable purposes within the meaning of section 501(c)(3) of the Code.

You Have a Substantial Nonexempt Purpose

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization does not qualify for exemption if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. A nonexempt purpose may be evidenced by activities that are conducted in a commercial manner or for a commercial purpose. Indeed, in discerning whether an organization has a substantial nonexempt commercial purpose, courts focus on a number of factors related to the nature of the activities and how an organization conducts its business, including pricing policies, funding sources, and the organization's competitiveness with and similarity to other commercial ventures. *See* B.S.W. Group, *supra*; Easter House, *supra*; Airlie Foundation, *supra*; Living Faith, *supra*.

Like the organization in Solution Plus, *supra*, a substantial part of your activities consists of the promotion and delivery of financial and other services to individuals for a fee. Your fee structure demonstrates that you are operated in a commercial manner and for a commercial purpose. You charge $695 to provide the full range of consulting services offered under the Consulting Agreement. These fees do not entitle your clients to any educational programs or services beyond those that are offered by for-profit businesses. This is evidenced by the fact that Related LLC charges exactly the same rates for exactly the same services. Furthermore, you have not established that you provide these services on different terms, at prices significantly below market, or in any other way that deviates from normal commercial practice. Indeed, you indicated that the fees you charge are "standard for the services provided."

Moreover, adopting a fee structure that is identical to that used by a for-profit corporation demonstrates that you are operating like a commercial organization seeking to maximize profits, rather than a charitable or educational organization seeking to serve the public. As you stated, your objectives are the same as Related LLC, but you were set up to "take advantage of the opportunities that are not available to for profit entities." As in Housing Pioneers, *supra*, an arrangement that takes advantage of a non-profit organization's exempt status to benefit a for-profit entity is evidence of a substantial nonexempt purpose. Moreover, you expect to have a profit margin above 47% in your first year, yet did not budget any money for educational or charitable activities. Your compensation structure is based in part on revenues, thus further demonstrating that you are focused on profits. As in Easter House, *supra*, the profit-making fee structure of your consulting services overshadows any of your other purposes.

The lack of public support for your activities further demonstrates that you operate for a substantial nonexempt commercial purpose. The exempt organization described in Consumer Credit Counseling Service of Alabama, *supra*, received support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. While you indicated that you will fundraise and solicit government grants, there is no evidence

that you have received any government grants and you do not have a substantive plan to solicit grants in the future. There is also no evidence that you have received contributions or gifts from disinterested members of the public. *See* B.S.W. Group, *supra* (citing lack of solicitation of contributions and sole support from fees as factors disfavoring exemption). Rather, your operations are financed entirely by revenue earned from selling services to lenders, real estate investors, and homeowners and by fees received from lenders for resolving loans without foreclosure. Receiving support primarily from consulting fees is indicative of a nonexempt purpose. Easter House, *supra*.

You conduct many of your activities, which are normally carried on by commercial enterprises for a profit, in the same commercial manner and in direct competition with commercial businesses like the organizations in Easter House, *supra*, Airlie Foundation, *supra*, and Living Faith, *supra*. In fact, you share office space, a website, directors, and employees with Related LLC, a commercial firm that conducts a similar business. As discussed above, you use a similar pricing and financial structure to Related LLC. You have also indicated that you will use a similar approach to advertising and networking. Moreover, as a substantial part of your activities you provide consulting services for a fee to lenders, in addition to homeowners; however, helping lenders avoid going through the foreclosure process serves a commercial, rather than charitable, purpose. In addition, you plan to enter into joint ventures with partners that are not section 501(c)(3) organizations, such as realtors, which may result in you providing consulting services for "mortgage companies, private investors of loans or others where review of process or assisting with the resolution of loans is of primary importance." Your plan to enter into these joint ventures also serves a commercial rather than charitable purpose, and further demonstrates that you have a substantial nonexempt purpose.

The activities you identify as educational are merely incidental to your business of providing foreclosure consulting services for a fee. Thus, more than an insubstantial part of your activities are in furtherance of a nonexempt purpose, in contravention of section 1.501(c)(3)-1(c)(1) of the regulations. Therefore, you are not operated for an exempt purpose.

Inurement

An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 501(c)(3) of the Code; Section 1.501(c)(3)-1(c)(2) of the regulations.

Your net earnings inure to the benefit of your directors. You provided a lease agreement entered into between Related LLC and a lessor. The lease calls for Related LLC to pay annual rent of $16,992 in 2008 and 2009. You indicated that you share office space with Related LLC and listed your occupancy expense as $16,992 in 2008 and 2009 – the exact amount of annual rent due under the lease signed by Related LLC. This indicates that you paid the full amount of the rent due under a lease entered into by Related LLC in 2008 and 2009, despite the fact that Related LLC was still conducting operations at this location. Thus, by allowing Related LLC to conduct operations at this location rent-free you conferred a direct benefit on your directors, who own Related LLC. As in Housing Pioneers, *supra*, an arrangement that takes advantage of an exempt organization's funds to benefit insiders constitutes inurement.

In addition, your directors determine their own salaries. How much they pay themselves is based on several factors, including anticipated revenues and the value they attach to their own experience and industry levels. The amounts have not been negotiated at arm's length, nor are they based on objective factors or an independent appraisal. Their initial aggregate fixed compensation exceeds 50% of your projected revenues. Your directors also intend to pay themselves discretionary bonuses and other non-fixed compensation based on the results of the business. There is no upper limit on the amount of your directors' compensation. Compensation based on a percentage of revenues with no limit has been held to be inurement. People of God Community, *supra*. The fact that your net earnings are paid out in the form of salary and bonuses rather than dividends does not change the substance of the arrangement.

You do not have adequate safeguards to protect you in your dealings with Related LLC. There is no evidence that your conflict of interest policy (COI) was executed by your governing body. Even if it were properly executed, under the terms of your COI, both of your directors are prevented from determining whether a conflict exists with regards to transactions or arrangements with their for-profit organization, Related LLC. Despite your inability to determine whether a conflict of interest exists under your COI with regard to dealings with Related LLC, you continue to share office space, employees, stationary, and a website with Related LLC. You did not provide evidence that your directors will be prevented from using you to reduce the expenses of their for-profit business. You did not indicate how or when you would determine which potential clients are seeking your services as opposed to Related LLC's services. You did not establish that you will segregate your clients in a way that ensures Related LLC does not usurp your opportunities. As was the case in Orange County Agricultural Society, *supra*, your directors have control over financial decisions with a related entity that stand to benefit them personally, yet you provided little evidence that your net earnings will not inure to their benefit.

Your net earnings inure to the benefit of your directors through your compensation arrangement and their ownership of Related LLC. Therefore, you are not described in section 501(c)(3) of the Code.

Private Benefit

An organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. *See* section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

The consulting services you provide to for-profit corporations substantially benefit lenders and investors. Helping a lender or investor to avoid going through the foreclosure process serves their private interests, rather than any public purpose. In addition, you perform a monitoring function on behalf of the lender or investor, as well as other functions they would otherwise have to perform.

Further, your activities substantially benefit Related LLC. The information you provided indicates that your occupancy expense in your first two years of operation is equal to the amount of rent due under the lease signed by Related LLC, and demonstrates that you are providing significant financial support to a related for-profit corporation. In addition, you stated that you have the same objectives as Related LLC and were formed to take advantage of the opportunities that are not available to for-profit entities. Although you did not explain further, it

appears that you were referring to government grants available only to exempt organizations and eligibility to become a certified HUD counselor. This suggests that one of your purposes is allowing a for-profit business to take advantage of your exempt status. Housing Pioneers, *supra.*

Similarly, your operations substantially benefit your directors. Your board of directors is composed of only two persons, both of whom stand to gain financially from your compensation structure and the benefits you confer on Related LLC. In Solution Plus, *supra*, the Tax Court found that an organization operated for private rather than public benefit when its directors, like yours, personally gained from the organization's activities in the form of compensation based on sales levels of financial services. Moreover, the composition of your board is in stark contrast to the exempt organization in Rev. Rul. 69-441, *supra*, whose board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions. The fact that your board lacks public participation of any kind further indicates that you are operated for the benefit of your directors, rather than the public.

Because your operations substantially benefit lenders and investors, Related LLC, and your directors, you have not demonstrated that your operations serve a public rather than a private interest as required by section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

Section 501(q) of the Code

An organization that provides educational information on financial topics or financial counseling to homeowners who are at risk of foreclosure is providing "credit counseling services" within the meaning of section 501(q)(4)(A) of the Code. An organization that engages in such activities as a substantial purpose must, in addition to complying with the requirements of section 501(c)(3), comply with the provisions of section 501(q). Thus, even if you had established that you engage in such activities as a substantial purpose, to be exempt from taxation you must, in addition to complying with the requirements of section 501(c)(3), comply with the provisions of section 501(q). You do not meet the requirements of section 501(c)(3) and you do not meet the requirements of section 501(q).

An exempt credit counseling organization must establish and implement a fee policy which requires that any fees charged to a consumer for services are reasonable and allows for the waiver of fees if the consumer is unable to pay. Section 501(q)(1)(C) of the Code. You failed to establish that you have such a fee policy.

Credit counseling organizations must be governed by a board controlled by persons representing the broad interests of the public rather than by persons who benefit from the organization's activities. Section 501(q)(1)(D) of the Code. All of the voting power of your board of directors is vested in persons who are employed by the organization and who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the repayment of consumer debt to creditors other than the credit counseling organization or its affiliates). Accordingly, you do not have a board of directors that is controlled by persons who represent the broad interests of the public as required by section 501(q)(1)(D)(i). You also fail to meet the requirements of sections 501(q)(1)(D)(ii) and (iii), which generally specify the percent of voting power that is allowed to be vested in financially interested persons.

Therefore, had you established that you otherwise met the requirements of section 501(c)(3), your failure to satisfy the requirements of section 501(q) would prevent you from being exempt from taxation under section 501(a).

Conclusion

Based on the facts and information provided, you are not organized or operated exclusively for exempt purposes as required by sections 1.501(c)(3)-1(b)(1)(i), 1.501(c)(3)-1(a)(1), and 1.501(c)(3)-1(c)(1) of the regulations. You are organized and operated for a substantial nonexempt purpose in contravention of section 1.501(c)(3)-1(c)(1) of the regulations. Any public purposes for which you may operate are only incidental to this primary nonexempt purpose. You have not demonstrated that you do not allow your net earnings to inure to private individuals as required by section 1.501(c)(3)-1(c)(2) of the regulations. You do not serve a public rather than a private interest as required by section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Therefore, you are not described in section 501(c)(3). In addition, you do not meet the requirements of section 501(q).

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns. Contributions to you are not deductible under section 170.

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

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

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

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

the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

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

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

Internal Revenue Service
1111 Constitution Ave, N.W.
Washington, DC 20224

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

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations