Internal Revenue Service
Appeals Office
1000 South Pine Island Road
Suite 350
Plantation, FL 33324

Release Number: **201129055**
Release Date: 7/22/2011
Date: April 27, 2011
UIL Code: 501.00-00

A

B

Certified Mail

Department of the Treasury

Person to Contact:

Employee ID Number:
Tel:
Fax:
Refer Reply to:
AP:Area 4:
In Re:

EIN:
UIL: 501.00-00
Form Required to be Filed:
1120
Tax Period Ended:

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 IRC Section 501(c)(3) effective October 1, 2004.

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

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

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

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 from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

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

Sincerely,

Charles Fisher
Appeals Team Manager

Internal Revenue Service **Department of the Treasury**

Taxpayer Identification Number:

Date: June 16, 2005

Form:

ORG
ADDRESS

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG		Tax Identification Number	Year/Period ended September 30, 20XX September 30, 20XX

LEGEND
ORG = Organization name XX = Date City = city State = state News = news
RA-1 & RA-2 = 1ST & 2ND RA DIR-1, DIR-2, DIR-3 & DIR-4 = 1ST, 2ND, 3RD & 4TH DIRECTORS
CO-1, CO-2, CO-3, CO-4, CO-5, CO-6 & CO-7 = 1ST, 2ND, 3RD, 4TH, 5TH, 6TH & 7TH COMPANIES

Issues:

Whether ORG is operated exclusively for one or more purposes as described in section 501(c)(3) of the Internal Revenue Code, more specifically, for charitable and educational purposes?

Whether the credit counseling activities conducted by ORG are substantial in nature and its primary activities?

Whether ORG has a substantial non-exempt and commercial purpose by providing debt management program services for a fee to the general public, providing both front end and back end service processing for its debt management program?

Facts:

Organizational and Tax-Exempt Status Data

ORG (ORG) was incorporated October 12, 20XX, in the state of State under the name "ORG" ORG's board of directors and officers consisted of the following individuals none of whom were related.

DIR-1	Director, Executive Director
DIR-2	Director
DIR-3	Director
DIR-4	Director

The ORG original Articles of Incorporation provide that its purposes are as allowed by federal and state statues, including consumer debt consolidation services. ORG filed Amended Articles of Incorporation on March 9, 20XX providing purposes as engaging exclusively in educational and/or charitable purposes limited by the requirements of 501(c)(3) including specifically, consumer debt consolidation services.

ORG received an acknowledgement from the IRS dated May 2, 20XX that their application for recognition of tax exempt status had been received. In its application ORG stated that 70% of the organization's time would be spent on client education and services, including debt settling and repayment. The application stated that there were plans for seminars and a newsletter. Information was to be made available to the general public free of charge. All counseling was to be done on their premises. The funding for ORG was to come 65% from administrative fees and 35% from creditor donations.

In a letter from the Internal Revenue Service dated September 20, 20XX, ORG was recognized as being exempt from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code. An advance ruling was made on its private foundation status, which was to end September 30, 20XX. The service determined that ORG could reasonably be expected to meet the requirements of being a publicly supported organization as described in sections 509(a)(1) and 170(b)(1)(A)(vi).

In a final determination letter dated November 28, 20XX, the IRS stated that ORG's foundation status would be under Section 509(a)(2) as a publicly supported organization.

Examination and Form 990 Information

ORG's Forms 990, Return of Organization Exempt from Income Tax, were examined for the years ended September 30, 20XX and September 30, 20XX. In Part III of its Form 990 returns, Statement of Program Service Accomplishments, ORG listed its accomplishments in the areas of educational outreach and numbers of counseling sessions conducted via telephone. Credit Counseling is listed as its primary exempt purpose.

In describing its exempt purpose achievements, ORG provided the following information on its Form 990 returns for the examination years:

Form 990 – September 30, 20XX

Number of educational/workshop/outreach in person contacts (local) (approximate per year)
Persons counseled regarding credit and personal/family budgeting
Persons accepted into Debt Management Plans (DMPs)
Percentage of counseled persons accepted for debt management plans %
Number of Express educational publications, invitations, handbooks, lesson/materials,
Brochures (paper and CDs), distributed (approximate per year)
Hours training for management and employees per average month
Hours training for new and transfer employees – average per employee

Form 990 – September 30, 20XX

Persons counseled regarding credit and personal/family budgeting (approximate) per Fiscal Year 20XX
Persons accepted into debt management plans to be managed by ORG during Fiscal Year 20XX

Name of taxpayer	Tax Identification Number	Year/Period ended
ORG		September 30, 20XX September 30, 20XX

Percentage of counseled persons accepted into Debt Management Programs during Fiscal Year 20XX %
Outreach contacts, including Workshops (local)(approximate) per month during Fiscal Year 20XX
Number of ORG educational publications and materials mailed by ORG (approximate) per month during during Fiscal Year 20XX to
Number of ORG educational publications and materials mailed by ORG during Fiscal Year 20XX to
Number of ORG educational publications and materials sent via fax and email per month during Fiscal Year 20XX
Number of ORG educational publications and materials sent via fax and during Fiscal Year 20XX
Approximate hours training for management and in-service employees per month
Approximate hours training for each new employee 60-90

Income reported on Forms 990 for the years examined were as follows:

Revenue Sources:	09/30/20XX	09/30/20XX	
Contributions			
PSR – Enrollment Fees			
PSR – Monthly Account Service Fees			
PSR – Creditor Fairshare Payments			
Interest/Dividends			
Rental Income			
Gain or loss – Sales of assets other than inventory			
Totals			

Though not disclosed completely in the table above "Contributions" included income from the following sources:

- Client Debt Management Plan setup fees
- Client Debt Management Plan monthly administrative fees
- Creditor Fair Share payments and Grants from creditors.
- Rental Income[1]
- Interest on investment accounts

[1] During 20XX and 20XX ORG subleased a portion of its unused office space to an unrelated third party.
Gross rents were $ in 20XX and $ in 20XX.

Credit Counseling and Debt Management Plan Activities

ORG operations are similar to those of a traditional consumer credit counseling organization. During the examination years, ORG relied on an established group of companies that were referred to as "lead generation service providers" (LGS) to deliver to ORG potential debt consolidation applicants to be enrolled into Debt Management Plans (DMP). The LGS providers were mostly unrelated for-profit entities that made telephone call solicitations to potential customers. Some customer leads came via ORG's own Internet website. ORG did no direct advertising for potential clients nor did ORG purchase any of their clients from other consumer credit counseling agencies. Persons making inquires on the website would wait for a credit counselor to call them back using the personal data entered in the on-line application.

When the telephone contact was made by one of the LGS companies with a perspective debt consolidation client, they obtained the personal and credit information and then the calls would be transferred to an ORG credit counselor. If the customer actually enrolled in a DMP with ORG the LGS would then earn a fee and sometimes the arrangements called for a monthly fee to be paid to the LGS company as long as a client continued to be enrolled in a debt management plan.

During the years under examination most of the clients were charged a one time setup fee, occasionally it was waived. The setup fee was based on the amount of unsecured debt the potential client had. ORG also charged the DMP client a monthly administrative fee for maintaining their account. Sometimes these fees were waived or reduced depending on the client's individual circumstances. Some of the individual states where ORG clients reside have established limits on the amount of credit consolidation fees that are allowed. In later years the ORG fees structure has changed. Currently the clients are still charged a set-up fee and monthly account administration fee, but they are much lower than they were in 20XX and 20XX.

During the examination years, ORG had several different LGS that provided them with potential clients. ORG paid the LGS commissions based on contractual arrangements and the monthly DMP fees collected from the debt consolidation referrals. During the year ended September 30, 20XX ORG spent in excess of $ and in the year ended September 30, 20XX more than $ in commissions and fees to the LGS companies to provide leads.

ORG entered into a written contract with each one of the LGS providers for their business relationship. The contracts have been revised over time, new ones added and old ones discontinued during the examination period, however, the objective of the contracts and the business relationships have remained consistent. The LGS acquire debt consolidation leads and make client referrals to ORG in order for their credit counselors to talk to the clients for potential DMP enrollment, processing, and servicing.

Broker Contracts, Compensation and Financial Arrangements

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended September 30, 20XX September 30, 20XX

During 20XX and 20XX ORG contracted with LGS providers to solicit and procure customers. These marketing agreements included clauses such as:

The Corporation (ORG) is in the business of providing debt consolidation services and wants to appoint contractor for marketing of the corporation's services.

- Contractor is hereby authorized to solicit and procure applications for the Corporation (ORG) and submit all new customers and potential customers to the corporation.
- Promotions shall include, but not be limited to television, radio, websites, tapes, videos, newspaper, infomercials, scripts, or other advertising literature or mediums approved by the corporation.
- The contractor shall provide these services exclusively for the corporation.
- The contractor must be in compliance with all state and federal law concerning telephone solicitations, telemarketing and do-not call lists.

During 20XX and 20XX, the manner in which the corporation (ORG) compensated contractors varied with the different contractors, both in terms of fixed payment amounts and percentage payments. All contractors are specified as independent contractors. The following are examples from the various agreements:

- Corporation will pay a fee of $ of the initial client payment for up to 299 new customers produced per week, $ for 300 to 499 new customers produced each week, $ for 500 to 999 new customers produced each week. If more than 1,000 new customers are produced in a week the amount will be renegotiated by the parties. The corporation shall pay $ per month for each client they retain in the program. Under no circumstances shall the fee be more than the initial payment made by the new client
- Corporation will pay a fee of $ of the initial client payment for up to 299 new customers produced per week, $ for 300 to 499 new customers produced each week, $ for 500 to 999 new customers produced each week. If more than 1,000 new customers were produced in a week the amount will be renegotiated by the parties. Under no circumstances shall the fee be more than the initial payment made by the new client.

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended September 30, 20XX September 30, 20XX

- Corporation shall pay a fee of $ for every consumer transferred to the corporation that enrolls in a DMP up to 99 per week, $ for 100 to 149 that enroll in a DMP per week, and $ for every consumer transferred to the corporation that enrolls in a DMP of 150 or more clients per week.

- Corporation shall pay a fee of $ per month for every consumer as long as they remain in the program. If the $ monthly maintenance fee is reduced then the $ fee will be prorated.

ORG's use of the LGS providers was revenue driven. The strategy was simple and straight-forward:

- To build a network of contractors in order to have an adequate flow of potential clients and debt consolidation applicants;
- To enroll qualifying debt consolidation applicants as DMP clients; and
- To build up its DMP portfolio to increase ORG's revenue stream.

During the examination years, ORG's DMP portfolio was comprised as follows:

[redacted]	**DMP Client Population**						
Tax Year	**Beginning of Year**		**Enrollments**		**Portfolio Acquisitions**		**End of Year**
Sept. 30, 20XX							
Sept. 30, 20XX							

During 20XX, ORG employed approximately 23 credit counselors. In 20XX ORG employed approximately 31 credit counselors. The credit counselor duties, in part, consisted of receiving call leads of potential consumers from the LGS providers, making outbound calls to client leads, and talking to individuals from other sources, obtaining the consumers financial history and if they qualified enrolling them into a debt management plan.

ORG initiates and completes the processing of the DMP application. It verifies and perfects the applicant data, submits DMP proposals to creditors and resubmits them on occasion. After the proposals are approved ORG collects the client payments and disburses the payments to the clients' creditors. ORG sends each client a monthly statement of account along with a chapter from *the Treasury of Practical Financial Knowledge*, which was written in house by the director of the Education Dept. For the most part, servicing a DMP entails making electronic withdrawals from a client's bank account via an electronic withdrawal (ACH), depositing the withdrawn funds in the DIR-1, P.A. Trust Account, (CO-2) and then making electronic disbursements from the CO-2 account into the ORG disbursement account, or directly to CO-1 (the payment processing company), who actually transmits the client creditor payments. Disbursements from the CO-2 account also were made to the ORG Operating Account to pay expenses of the operation and to the ORG Payroll Account for employee salary payments. By performing the foregoing services, as a substantial part of its

activities, ORG is essentially providing debt consolidation services for a fee. ORG acted as the servicing agent for DIR-1, a licensed attorney and the executive director of ORG. This arrangement was set up as ordered by a court appointed trustee, RA-1 in December of 20XX.
This arrangement was changed somewhat in the first quarter of 20XX. A new for-profit entity, CO-3 (CO-3) owned by CO-2 Holdings now receives all of the client payments, makes the disbursements of client funds and pays the operating expenses.

The majority of customer complaints received by ORG through the Better Business Bureau or directly to their office were promptly addressed and the majority of the complaints were resolved. In the correspondence ORG referred to itself as a non-profit organization acting as the servicing agent for licensed attorney DIR-1.

Credit Counseling Activities

Credit counselors and other employees involved in ORG's DMP operations make up the majority of its employees. During the examination years, 60% or more of ORG employees were Credit Counselors or Customer Service representatives. See the table below.

ORG Departments	Number of Employees 9/30/20XX	9/30/20XX
Credit Counseling Center	23	31
Account Maintenance	6	9
Business Operations/Legal	3	3
Customer Service	16	18
Disbursements	6	6
Educational Services	3	3
Human Resources/Financial Operations	5	6
Information Technology	3	3
Total Employees	65	79

ORG's credit counselor duties include:

- Counseling clients according to their budget & financial needs,
- Consolidating client unsecured credit accounts and
- Negotiating with the client creditors for lower payments and lower interest rates.

Hiring Practices

After reviewing the ORG job announcements for credit counselors it was determined that in order to be employed as a credit counselor at ORG, a person did not need any formal training or experience in the areas of credit or financial counseling, money management, or counseling in general. The education requirements for credit counselors at ORG were a high school diploma or equivalent, related work experience, an understanding of debt consolidation, computer skills, and desire to grow and learn. Other factors and skills preferred included:

- Oral and written communication skills
- Ability to multi-task in a high-volume environment
- Customer service/sales experience preferred
- Professional attitude
- Self-motivated
- Bilingual

Credit Counselor Training

The new counselors begin with a week of orientation covering the employee handbook, company benefits, ORG itself, the executive director, the various departments, the department managers and the overall structure of the organization, the telephone system, receiving and transferring calls. They learn how to use the computer from start up, accessing the database, adding customers, the debt calculator, entering customer data, calculations and due dates. The initial training could last two weeks. Some of the credit counselors begin handling inbound calls after the first week of orientation at ORG. There is also individual study and listening in on live calls with an experienced senior representative. The total training time depends on how quickly the individual picks up the job and their prior job experience. Advanced training and making outbound calls is normally after about 2 to 4 weeks. Beginning in March of 20XX ORG credit counselors are required to obtain & maintain certification through the National Institute for Financial Counseling and Education (NIFCE). Within 90 days a counselor must begin this self-study and then complete the course and pass a written test.

Analysis of Credit Counseling Telephone Conversations

For the time spent on-site during the examination at ORG's offices, the Examining Agent was assigned to a conference room downstairs from the administrative offices and the credit counseling center, which was not suitable to listen to live telephone calls. ORG provided 22 initial recorded credit counseling telephone interviews. These were recorded between October and December of 20XX. ORG stated that there were no recordings maintained during the years under examination. The calls were provided by RA-2 the New Accounts Department manager in a .wav file format on a CD Rom disc. The 22 calls represented the work of 15 different credit counselors. The calls were categorized into 4 types; fax calls were those completed and waiting for contracts to be faxed back to Express (avg. time of call 34 minutes), non-qualify individuals (avg. time of call 10 minutes), qualifying (avg. time of call 18 minutes) and other calls (avg. time of call 18.5 minutes).

Common with all of these calls was the verifying of the consumer's telephone number, a brief budget analysis including take home pay and general monthly expenses, options for the consumer mentioned were budget modification, a debt management plan, bankruptcy, home equity loans or home refinancing or second a mortgage. Each consumer was told they would receive an "action plan" with information on the different options. Bankruptcy is rarely mentioned as an option, home equity loans and refinancing or second mortgages are never recommended as an option as those could lead to more problems, like putting their home at risk. The recommendation to the qualifying consumers was always budget modification (changing spending habits) and DMP. There is very little given to the client in the way of education or individual budget and financial advice. Changing spending habits is mentioned as part of the budget modification, but no specific suggestions or recommendations are given as to how the client might accomplish this in their individual situation. The majority of these calls were transferred from one of the lead generator service providers (LGS) with the creditor information who turned them over to the ORG credit counselor. Every credit counselor advises the consumer at least once or twice that CO-4 is the servicing agent for licensed attorney DIR-1. In preparing budgets to submit DMP proposals, counselors would sometimes tell prospective clients that there shouldn't be too much left over in their budget, but that they can afford the payment required of a DMP.

One of the statements made by the executive director from the first interview was that ORG was changing and trying to improve and correct what had been done wrong in the past and to follow the guidelines of the IRS for credit counseling agencies. A second set of recorded credit counselor calls was requested and received. There were 20 calls recorded between November 20XX and February of 20XX. The calls were in an audio format on CD Rom which represented the work of 10 different credit counselors and included both qualifying and non-qualifying clients. Almost all of these calls were Leadpoint Voice Lead referrals. There is no longer any mention of the Counseling Center being a tax-exempt or non-profit organization. There were completed calls with DMP agreements, some with verbal agreements, but not finalized and some where the client did not meet the criteria for the DMP program. As part of the changes the agreement with attorney DIR-1 was ended and a new entity set up to enter into the DMP client agreements. CO-2 (CO-3) in City, State was established in the first quarter of 20XX and the later calls were answered representing the Counseling Center as CO-3, except for one or two where ORG was stated as the company being represented. The counselors used the same script for the calls obtaining personal information, explaining that the organization provides financial options including DMPs and drastically lowering interest rates. The counselors go right into obtaining creditor information, listing credit cards and other unsecured debts, personal loans and medical bills. They ask how old the accounts are and who is responsible for the debts. The counselors do a budget analysis obtaining monthly income and expense estimates and information on any assets the client may have. The options mentioned are budget modification, DMP, bankruptcy, second mortgage, home refinancing or home equity loans. Budget modification and DMP are always suggested unless a client does not qualify and then they might suggest bankruptcy, but only a last resort. Home loans, home refinancing and second mortgages are never suggested. The clients are told that they will receive an action plan with information on the options. There is still little specific financial information or advice for the individual. Changing spending habits and cutting back on expenses is sometimes mentioned, but no specific recommendations as to how a client might accomplish it. A couple of times the idea of a second job was mentioned. Neither the EO website nor other financial educational resources were mentioned to the clients. The majority of the time of the calls was spent gathering the creditor information and the client budget information. One thing noted in the second group of counselor calls was that the fees were reduced for both set up and the monthly account administration.

Scripts Use by Credit Counselors

During 20XX and 20XX, ORG provided its credit counselors with scripts to use in different situations when speaking with consumers and perspective clients, i.e. inbound calls, outbound calls and transferred calls. One thing that was always made clear was that ORG operated as the servicing agent for licensed attorney DIR-1. The credit counselor would identify themselves by name, ask for the client's personal information and preliminary financial and budget information, (income, expenses, assets & any liabilities, credit card payments and amount of debt). They state that they need to get the consumer's information to recommend the best course of action for them. They tell the consumer they will be sent a budget "action plan" in writing with the counselor's recommendation of the best course of action for the consumer. Each contacted consumer is given a CID (client identification number) whether they enroll in a DMP or not. Scripts include help with frequently asked questions such as who DIR-1 is, the debt consolidation process, what ORG is, the option of bankruptcy, the DMP fees, what if the client receives harassing collection calls, what if they pay off early, how does DMP affect their credit score, what types of debt can be included in a DMP, what if a client doesn't have a fax machine. The majority of the script information relates to DMPs, either the enrollment process or how debt consolidation works. If a consumer agrees to sign up the counselor will read verbatim statements concerning the contract itself, where to sign and returning it back to the counselor within 24 hours to begin the progess. The fees structure is carefully explained, setup and account maintenance fees. The customer service toll-free number is given to them in case they need to call back. There were no scripts shown that had techniques on how to counsel with particular financial problems or money management issues. Each counselor had a set dollar limit based on the client's DMP payment that they can work without approval from a senior counselor or manager. If a call is over their limit it is "turned over" or transferred to one of these other persons to complete. If a client agrees to the DMP program sometimes the automatic bank account withdrawal was setup by another representative.

The later calls still used a script explaining briefly about the counseling center and common with all of the calls was verifying the client's name, address & phone number, a brief overview of what the Counseling Center does; presenting financial options, including DMPs and lowering interest rates. The counselors normally went right into listing the credit cards and other unsecured debts of the clients. They asked who was responsible for the debts and how old the accounts were. The counselors would do a budget analysis including take home pay and general monthly expenses. Client options mentioned were budget modification, the debt management plan, bankruptcy, home equity loans or home refinancing or second a mortgage. Each qualifying client is told they would receive an "action plan" with information on the different options. Bankruptcy is suggested only as a last resort. Home equity loans and refinancing or second mortgages are never recommended as an option. It is almost always budget modification (changing spending habits & cutting expenses) and DMP if the client qualified. There is very little given to the client in the way of education, budget or financial advice. The majority of the call time is spent gathering the client's creditor information. Changing spending habits is mentioned as part of the budget modification, but no specific suggestions or recommendations are given as to how the client might accomplish it. A few times a counselor would ask about a second job. Almost all of the calls were from the Leadpoint Voice Lead Referrals. Neither CO-4 nor CO-3 was mentioned as being a non-profit organization. Neither the EO website nor other financial educational resources were mentioned.

Credit Counselor Compensation

Credit counselor compensation was based on an hourly rate depending on the proficiency level they have reached. The counselors may qualify for a monthly bonus plan if they meet certain criteria. Qualifying for the bonus plan is based on the numbers of active client DMP accounts maintained and the number of pending DMP accounts. The following is a summary of the basic pay scales during the years of the examination.

Pay Levels:
C1 Representative
C2 Senior Representative
C3 Credit Counselor
C4 Senior Credit Counselor
To go from advanced training to the C1 level an employee must have 20 pendings (DMPs) from the non-pitched report in a 4 week period. These representatives handle the calls generated from vendor CO-5.

C1 New Reps. make $ per hour & are eligible for a $ monthly bonus package
Goals; 45 pendings, 31 active, perfect attendance and a monitoring score of 3.0 or higher

(According to the charts provided 60% of the basis for bonuses is active and pending accounts and the other 40% is attendance and monitoring scores.)

C2 Senior Reps. make $ per hour & are eligible for a $ monthly bonus package
Goals; 50 pendings, 35 active, perfect attendance and a monitoring score of 3.0 or higher

C3 Credit Counselors make $ per hour & are eligible for a $ monthly bonus package
Goals; 60 pendings, 42 active, perfect attendance and a monitoring score of 3.0 or higher

C4 Senior Credit Counselors make $ per hour & are eligible for a $ monthly bonus package
Goals; 70 pendings, 49 active, perfect attendance and a monitoring score of 3.0 or higher

Inbound call minimum bonus qualifiers
Call to fax ratio 50% or higher
Fax to pending ratio 40% or higher
Must achieve 80% or more of pending goal/active goal to receive 50% of bonus amount and 90% or more of pending/active goal to receive 75% of bonus amount.

These representatives handle vendor TDL calls, which typically take more time so the expectations are lower.
T1 Task force representative
T2 Task force credit counselor
T3 Task force senior credit counselor

T1 TF Reps. make $ per hour & are eligible for a $ monthly bonus package Goals; 36 pendings, 25 active, perfect attendance and a monitoring score of 3.0 or higher (According to the charts provided 60% of the basis for bonuses is active and pending accounts and the other 40% is attendance and monitoring scores.)

T2 TF Reps. make $ per hour & are eligible for a $ monthly bonus package Goals; 44 pendings, 31 active, perfect attendance and a monitoring score of 3.0 or higher

T3 TF Reps. make $ per hour & are eligible for a $ monthly bonus package Goals; 48 pendings, 34 active, perfect attendance and a monitoring score of 3.0 or higher

Task Force bonus qualifiers:
Fax to Pending ratio 40%, call to fax for TDL calls TBD this month, must achieve 80% or more of pending goal/active goal to receive 50% of bonus amount and 90% or more of pending/active goal to receive 75% of bonus amount.

Bonus Disqualifiers – Zero on a listening score, 2 or more write-ups per month, no call or no show, manager discretion, 2 or more absences in a month, late for work 3 times lose 50% of bonus, late for work 4 times lose 75% of bonus and late for work 5 times lose all bonus, and an average monitoring score below 2.5.

After 3 consecutive months of hitting bonus an employee may be recommended for advancement, also on their annual reviews. If bonus is not met for 3 consecutive months then the representative is put in the plan where his/her manager spends more time with them and monitors more calls.

Education Activities

Aside from what is deemed to be credit counseling, ORG's educational activities and materials during the examination years consisted of the following:

- Internet website
- Monthly newsletter, *"NEWS to Financial Freedom"*
- Outreach events, which included seminars/workshops, as well as, one-on-one assistance.
- *"The Treasury of Practical Financial Knowledge"* a series of financial lesson plans sent out a chapter a month to active DMP clients.

The ORG website contains educational content, as well as, references and links to other helpful information and governmental websites.

ORG's monthly newsletter, *"NEWS"* has been published for several years. During 20XX and 20XX ORG produced thousands of copies of its newsletter on a monthly basis and distributed them to their DMP clients by mail along with their individual statements of account.

All of the educational materials of ORG are available online. Educational materials will also be mailed to consumers upon request. ORG stated that the overwhelming majority of its counseling is done via telephone, but could be conducted in a face-to-face meeting at their office, but that would be rare.

Outreach Events

The educational programs for ORG during the year of 20XX included workshops, seminars, and elementary school classroom lessons. ORG provided event reports for 136 events that it conducted. Most were seminars/workshops with various topics for adults and children. For 20XX, ORG provided event reports for 67 events that it conducted. Most of these also were seminars or workshops with various topics for adults, children and teens.

Of the 203 events listed, approximately 949 adults were involved, 412 children and 642 teens. Among the 203 events, the following was noted:

- 76 of the events listed were at day care centers
- 48 of the events listed were at CO-6 a low income housing development in City and other housing developments in the area.
- 9 of the events were at community based service organizations
- 16 of the events listed were at local churches
- 47 of the events listed were at local Workforce Development Centers
- 5 of the events were for one-on-one assistance.
- 2 of the events were at CO-7, over 500 teens at assemblies

LAW:

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(b)(1)(i) of the Code provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its "articles") as defined in subparagraph (2) of this paragraph:

(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 which in themselves are not in furtherance of one or more 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(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

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

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or

(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

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.

A nonprofit organization formed to help reduce personal bankruptcy by providing information to the public on personal money management and aiding low-income individuals and families with financial problems is exempt under section 501(c)(3) of the IRC. Under a budget plan the debtor voluntarily makes fixed payments to the organization. The funds were kept in a trust account and disbursed on a partial payment basis to the creditors, whose approval of the establishment of the plan is obtained by the organization. These services are provided without charge to the debtor. Rev. Rul. 69–441, 1969–2 C.B. 115.

In Rev. Rul. 65-299, 1965-2 C.B. 165, a nonprofit organization advised, counseled, and assisted individuals in solving their financial difficulties, by budgeting their income and expenses and effecting an orderly program for the payment of their obligations, is entitled to exemption from Federal income tax as a social welfare organization described in section 501(c)(4) of the IRC. No charge was made for the counseling service and only a nominal charge was made for the monthly prorating services, to cover postage and supplies.

In *Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945)*, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In American Institute for *Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962)*, the Court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed arguendo that the organization had an educational purpose. However, the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was indicative of a business. Therefore, the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

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 is 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 dept management plan. Approximately 12 percent of a professional counselor's time was applied to the dept management plan as opposed to education. The agencies charged a nominal fee of up to $10 per month for the dept management plan. This fee was waived in instances when payment of the fee would work a financial hardship. The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from service fees.

The court found the organizations exempt under section 501(c)(3) because providing information to the public regarding the sound use of consumer credit is charitable in that it advances and promotes education and social welfare. These programs were also educational because they instructed the public on subjects useful to the individual and beneficial to the community. The counseling assistance programs were likewise charitable and educational in nature. Because the community education and counseling assistance programs were the agencies' primary activities, the agencies were organized and operated for charitable and educational purposes. The court also concluded that the limited debt management services were an integral part of the agencies' counseling function, and thus charitable, but stated further that even if this were not the case, these activities were incidental to the agencies' principal functions.
Finally, the court found that the law did not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under section 501(c)(3) or to provide its services solely without charge. Nonetheless, these agencies did not charge a fee for the programs that constituted their principal activities. They charged nominal fees for services that were incidental. Moreover, even this nominal fee was waived when payment would work a financial hardship.

In *Easter House v. U.S., 12 Ct. Cl. 476 (1987), aff'd 846 F.2d 78 (Fed. Cir 1988)*, the court found that adoption services were the primary activity of the organization. In deciding that the organization conducted adoption services for a business purpose rather for a charitable purpose, the court considered the manner in which the organization operated. The record established a number of factors that characterize a commercial activity and which were evident in the operations of Easter House also. The court determined that the organization competed with other commercial organizations providing similar services; fees were the only source of revenue; it accumulated very substantial profits, because it set its fees in order to generate a profit; the accumulated capital was substantially greater than the amounts spent on charitable and educational activity; and the organization did not solicit and did not plan to solicit contributions. The court also found a corporate-type structure in the classes of memberships (including a single life member having inherent power that the holder could transfer like stock), and dependence on paid employees.

Government's Position

The primary issue in this examination focuses on whether or not ORG's primary purpose is providing budgeting and financial education or is its primary purpose to provide fee-for-service debt consolidation services. It is the government's position that while ORG does engage in various educational activities that a substantial part of its activities are in providing fee-for-service based debt consolidation services, first by obtaining enough financial information from individual prospects to determine qualification for a DMP and then enrolling them in a debt management program. However, with certainty, ORG is not like the credit counseling organization in *Consumer Credit Counseling*

Service of Alabama, Inc. or like the one described in Rev. Rul. 69-441. The organizations described in these rulings charged little or no fees in relation to the educational or debt consolidation services that were provided. The government's position is that ORG's educational and charitable activities are not substantial in comparison to the services provided to its clients through the DMP enrollment.

The method used by ORG to obtain the majority of its clients came through lead generation service providers (LGS) and the executive director himself stated that the major reason the individuals call in it is for the purpose of getting help with their credit card debt. After listening to a sampling of more than 40 recorded telephone conversations between clients and credit counselors it was noted that there was only a minimal amount of financial educational information or advice given. The credit counselors typically verify personal information, obtain minimal budget information and if a client qualifies the counselor would then attempt to enroll them in a debt management plan. The emphasis in each of the calls appears to be enrolling the clients in DMPs rather than the individual's financial situation or specific advice given to the callers.

The business model ORG and then in early 20XX CO-3 has developed is a network of LGS companies referring thousands of persons who have debt problems and need help. Obtaining DMP clients for ORG and CO-3 is easy. It simply involves talking to the referrals, gathering information, submitting DMP proposals to the creditors, collecting and then distributing the client funds electronically. Following this model, ORG and CO-3 earned money in three ways:

- Setup fees charged to each of the DMP clients when they enroll
- Monthly account maintenance fees for the clients who remain active in the DMP program and
- Creditor "fair share" payments or grants

ORG's revenue increased from 20XX through 20XX.

- At the end of September 20XX ORG had 12,585 active clients. ORG gross revenues for 20XX were $ increasing to $ in 20XX.

Three of the accomplishments cited by ORG were either about its DMP portfolio or increasing its DMP portfolio from sources of potential clients. It boasted that revenues and contributions nearly tripled from 20XX to 20XX. Substantially all of ORG's revenues were derived from fees and payments associated with its DMPs. ORG received zero charitable contributions during the years of the examination.

ORG did have three persons devoted to the educational department activities, including a full time outreach person who made presentations in the community, such as, outreach sessions, lectures and workshops. Also educational and reference information was provided via the ORG Internet website, its newsletter and through the mail out of the *Treasury of Practical Financial Knowledge* chapters each month. These workshops delivered educational material, however, the value of some of the material in the workshops as it relates to debt matters and financial information is questionable. Example, teaching young children to read and to count, while of educational value, not related to debt and financial matters.

The primary activities centered on the enrollment of qualifying persons into DMPs. There is really no education of the general public, except through the outreach events, the ORG website or through information mailed out if requested. More than half of ORG's work force was involved in the DMP service activities. Persons hired as credit counseling received some training in the area of credit counseling, but the emphasis was on handling customers and DMP enrollment, the processing and servicing of DMP accounts. Of the total revenue generated 99% was derived from DMP activities, and of that about 10-11% was from fair share payments and grants from the creditors.

Taxpayer's Position:

The taxpayer is not in agreement with the government's interpretation of what CO-4 is providing in the way of education to the individual client. After the counselor completes the budget analysis an action plan is formulated and given to the client. These action plans include information on ways to cut back on expenses along with an explanation of the various financial options that were discussed during the counselor interview. The action plans go out to every person who calls in, not just the clients who have enrolled in a debt management plan. The Internet web address is provided where the *"Treasury of Practical Financial Knowledge*" is available to everyone. Currently the taxpayer gets client leads from Leadpoint, a company which makes referrals based on the needs of the callers. Callers are transferred to CO-4 because they can provide the type of service certain callers need. It has already been determined by Leadpoint that a caller has a certain amount of debt and the type of debt. The taxpayer believes that every person who signs up for a debt management plan improves their financial situation, by getting lower interest rates, having only one payment per month, and the stopping of collection calls. The taxpayer feels like they are carrying out their exempt mission by providing financial education and doing what is best for the consumer. The taxpayer feels that the debt management program in and of itself is one of the best educational tools because while in a DMP the client can no longer use the accounts in the DMP and they are forced to modify their budget and spending behavior.

Conclusion:

Based on the examination conducted of ORG it is not operated exclusively for the purposes listed in IRC section 501(c)(3). During the examination it was determined that ORG's activities were primarily credit counseling and these activities were substantial. The credit counseling was operated for a substantial non-exempt purpose, which was commercial in nature.

It is therefore recommended that the Service's letter to ORG, dated September 20, 20XX, recognizing it as exempt from Federal income tax be revoked effective October 1, 20XX.