

Internal Revenue Service
Appeals Office
1375 E. Ninth Street, Suite 815
Cleveland, OH 44114-1739

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

Tax Period(s) Ended:

Form Required to be Filed:

Employer Identification Number:

UIL:

501.03-08

Number: **201132030**
Release Date: 8/12/2011

Date: May 19, 2011

A

B

Certified Mail

Dear _____ :

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code, effective January 1, 2001.

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

You are not operated for an exclusive exempt purpose as is required by Internal Revenue Code section 501(c)(3). You operate substantially for non-exempt purposes. In addition, you operate for substantial private, rather than public, purpose.

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.

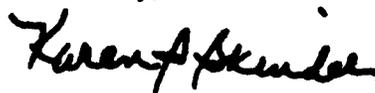
If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed

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.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Sincerely,

A handwritten signature in black ink that reads "Karen A. Skinder". The signature is written in a cursive style with a prominent initial "K".

Karen A. Skinder
Appeals Team Manager



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

July 25, 2005

Taxpayer Identification Number:

Form:

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.

Letter 3618 (04-2002)
Catalog Number 34809F

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

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

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

Thank you for your cooperation.

Sincerely,

R.C. Johnson
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

**XXXXX
SUCCESSOR – XXXXX
TAX YEARS ENDING XXXXX**

ISSUES

Whether XXXXX is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3):

Whether more than an insubstantial part of XXXXX'S activities is in furtherance of a non-exempt purpose?

Whether XXXXX was operated for the purpose of serving a private benefit rather than public interests?

Whether any part of the net earnings of XXXXX inured to the benefit of any private shareholder or individual?

Should the tax-exempt status of XXXXX be revoked for failure to operate exclusively for 501(c)(3) purposes and for violating the prohibition on inurement as set forth in Internal Revenue Code section 501(c)(3)?

FACTS

History of Control

XXXXX of XXXXX, was the Director and Chief Executive Officer of XXXXX (XXXXX) during XXXXX, the years under examination. He is also a founding member of the XXXXX (XXXXX).

XXXXX originally established XXXXX (XXXXX) dba XXXXX as a for-profit corporation, incorporated XXXXX under the laws of the State of XXXXX. It provided services for XXXXX's (XXXXX's) parent XXXXX (XXXXX) dba XXXXX, a nonprofit corporation incorporated XXXXX in XXXXX as well as other independent credit counseling agencies. XXXXX was President of XXXXX (XXXXX) dba XXXXX during XXXXX, the years under examination.

XXXXX (XXXXX) dba XXXXX had acquired the stock of XXXXX in XXXXX from XXXXX (50%) and XXXXX (50%). XXXXX had also acquired the stock of XXXXX (XXXXX) in XXXXX from XXXXX (30%), XXXXX (30%), and XXXXX (40%) who also works as a leased data processing employee for XXXXX. XXXXX had merged with XXXXX and the surviving corporation XXXXX became a wholly-owned for-profit subsidiary of XXXXX. XXXXX (XXXXX) dba XXXXX also took control of the board of XXXXX in XXXXX. XXXXX and Affiliates prepared consolidated financial statements for the years ended XXXXX.

XXXXX (XXXXX) and XXXXX (XXXXX) both of XXXXX had engaged XXXXX (XXXXX) dba XXXXX to process and provide ongoing support to XXXXX/XXXXX debt consolidation clients at a rate of \$17 per month per active client for its services. XXXXX/XXXXX was seeking to avoid a financially-challenging long-term commitment on debt management program activities, and agreed to transfer 375 credit counseling/debt consolidation clients to the newly incorporated XXXXX (XXXXX) for assumption of XXXXX service fee debt owed to XXXXX.

XXXXX (XXXXX) was incorporated XXXXX under the laws of the State of XXXXX as a nonprofit public benefit corporation. In its Articles of Incorporation, XXXXX stated its specific charitable and public purposes of the corporation are:

- (a) to provide for instruction, training, and counseling of individuals on consumer credit problems and family budgets,
- (b) to advise and mediate terms of repayment with the creditors of individuals experiencing financial difficulties, and
- (c) to educate the public on issues related to personal financial management

Exhibit I

In its Articles of Incorporation filed XXXXX, XXXXX stated that organization's property is irrevocably dedicated to charitable purposes, and no part of the net income or assets of this corporation shall ever inure to the benefit of any director, officer, or member of this corporation or to the benefit of any private individual.

On XXXXX, XXXXX entered an agreement to assume the ongoing credit counseling activities operated by XXXXX (XXXXX) of XXXXX. XXXXX transferred assets to XXXXX along with the existing Debt Management Plan client base of 375 active clients. XXXXX no longer desired to continue credit counseling/debt consolidation services because the cost of services by XXXXX (XXXXX) dba XXXXX caused XXXXX to lose money every month. XXXXX paid XXXXX \$17 per month per active client for its services. XXXXX agreed to assume the unpaid deferred service liability of \$63,937 due XXXXX for customer service, accounting, computer support, training, and other servicing of XXXXX clients through XXXXX. XXXXX agreed to satisfy such debt out of future earnings from the existing client base and pay XXXXX thirty-five percent of gross receipts (maintenance fees and fair share) attributed to those clients after XXXXX.

XXXXX intended to refer to XXXXX any of its housing counseling or other clients that were eligible for and/or interested in debt consolidation program services. XXXXX still refers people to XXXXX to help repair their credit and use the debt consolidation services of XXXXX's debt management program.

Secretary XXXXX submitted XXXXX's Form 1023 application for exemption under section 501(c)(3) on XXXXX. The exemption application stated that the organization was formed to provide education of the public on issues relating to household and/or personal financial management, and to provide instruction and training of individuals for the purpose of improving their capability in dealing with personal financial matters. The Form 1023 Application improperly responded "no" regarding any contractual agreements for management services. Form 1023 also omitted the unpaid deferred service liability of \$63,937 due XXXXX (XXXXX) dba XXXXX from its balance sheet.

The XXXXX directors held a Board Meeting XXXXX and decided to negotiate an Agreement with XXXXX. The new agreement dated XXXXX was signed by XXXXX as Chairman of the Board of XXXXX and XXXXX as Director of Operations for XXXXX. The SERVICE AGREEMENT provided for a price of \$18 per active client per month for Data Processing, Funds Collection and Disbursement Services, Customer Service, Management Information Support Services, Training, and Marketing. These processing and support services applied to existing XXXXX/XXXXX clients and to the new clients enrolled in debt management plans by XXXXX.

An IRS Determination Letter was issued in XXXXX for an advance ruling on exemption under section 501(c)(3) and not a private foundation under 509(a)(2) until XXXXX.

In XXXXX, XXXXX's Board amended its By-Laws to require five Directors, thus adding two. XXXXX agreed to this change. XXXXX said this was supposed to alleviate any responsibilities for her or XXXXX. XXXXX and XXXXX were nominated by XXXXX and

XXXXX and were added to the Board XXXXX. XXXXX (XXXXX) and XXXXX (XXXXX and XXXXX) are brothers.

XXXXX's Agreement with XXXXX was amended effective XXXXX. An agreement was reached for XXXXX, XXXXX, and XXXXX to offer their resignations contingent upon XXXXX dba XXXXX agreeing to satisfy payment terms of the XXXXX amended agreement with XXXXX. Such terms included payment of \$20,000 to XXXXX for XXXXX's unpaid deferred service liability and payment of an additional \$50,977 to XXXXX for XXXXX's unpaid debt and for an increase to the XXXXX full service monthly fee to \$18 for all active clients, hence agreement for sale of XXXXX.

Two directors XXXXX and XXXXX submitted signed resignations XXXXX. XXXXX appointed new board members XXXXX, XXXXX, and XXXXX from XXXXX (XXXXX) dba XXXXX prior to his resignation XXXXX. XXXXX and his wife XXXXX worked for XXXXX as leased employees in XXXXX.

XXXXX and XXXXX were chief executives in XXXXX (XXXXX) dba XXXXX and XXXXX became a controlled subsidiary of XXXXX and began using the XXXXX name, effective XXXXX. There was not public control.

XXXXX was a counselor for XXXXX's XXXXX, XXXXX office and the required resident of XXXXX on XXXXX's board of directors. XXXXX was hired by XXXXX in XXXXX who was then Director of Operations for XXXXX. XXXXX took over XXXXX XXXXX Office, effective XXXXX. XXXXX's counseling evaluations for the last quarter of XXXXX were Level 1 evaluations resulting in a proposed reduction in salary. XXXXX resigned XXXXXXX.

XXXXX was nominated and elected to the board XXXXX. XXXXX continued as a board member until organization merged, but he indicated that he was not involved in decision-making. XXXXX XXXXX and XXXXX, management of XXXXX, controlled the board.

XXXXX dba XXXXX, XXXXX, and XXXXX dba XXXXX (which merged in XXXXX with XXXXX.) merged, effective XXXXX. The surviving corporation is XXXXX, a nonprofit corporation in XXXXX governed by XXXXX as President and XXXXX as Chief Financial Officer and their designees.

A March 24, 2004 United States Senate Subcommittee Report entitled "Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling" states that tax-exempt organizations were founded as call centers for the purpose of referring business to for-profit service providers. XXXXX was one of several exempt organizations that signed fulfillment agreements with XXXXX (XXXXX) dba XXXXX, through which XXXXX performed all of the processing services for the exempt organizations and collected substantial fees for its services.

Historical Activities

In its Internal Revenue Service Form 1023, application for exempt status submitted XXXXX, XXXXX stated that its activities would provide education of the public on issues relating to household and/or personal financial management, and to provide instruction and training of individuals for the purpose of improving their capability in dealing with personal financial matters. Activities included the following:

- (a) Budget analysis
- (b) Income verification
- (c) Analysis of secured and unsecured debt
- (d) Development of a financial plan for the individual

Other activities to be performed included educational seminars or educational forums for the public on budgetary, credit, and money management issues.

XXXXX operated counseling offices and call centers in XXXXX, XXXXX, and XXXXX, XXXXX for XXXXX, whose purpose was to restore financial balance to people's lives. In some cases, counseling and DMP clients were referred by XXXXX and XXXXX. Consultants were required to handle leads, develop action plans, and enroll certain clients and retain them beyond 90 days in debt management plans (DMPs). If a DMP did not apply, they could recommend a self administered plan and advise the individual not to pay on their debts and to contact the counselor later so they could review the situation again (and possibly qualify for a DMP after some change). They also advised Chapter 7 bankruptcy.

The primary activity engaged in by XXXXX during the years XXXXX and XXXXX was telephone consultation of any individuals in financial distress. Organization received calls through the XXXXX telephone system and provided telephone consultation to callers to determine the source of their financial problems. The organization also engaged in face-to-face consultation and provided pamphlets, brochures, and books to clients. Individuals were evaluated for and screened for the possibility of enrollment in debt management plans (hereinafter DMPs).

Potential DMP clients were individuals with unsecured debt, primarily credit card debt. A DMP is a program whereby a client makes monthly payments to XXXXX and its affiliates to satisfy his/her unsecured debts over a 3-5 year period. Most of the debts handled in a DMP were credit card debts, but other unsecured debts such as hospital bills, student loans, tax debts, and payday loans were also managed through XXXXX DMPs.

The consultants sought DMPs acceptable to the creditors to receive fair share payments. They were also evaluated on retention of DMPs. E-mails and recordings indicate that there were problems with DMPs being rejected by management of XXXXX and its affiliates because DMPs that were rejected by creditors would affect XXXXX experience with creditors and percentages of fair share payments. To receive fair share payments, the organization fit into a system created by the creditors.

Call Center Counseling/Screening

In a typical call with a potential client, the employees introduce themselves as employees of XXXXX, a non-profit corporation, and advise that they can help restore financial balance to the person's life. XXXXX's consultants were instructed to collect accurate information from the client during the consultation session to include names and addresses, home phone, work phone and fax, email address and social security number. Consultants were trained to establish a clear purpose or motive for the consultation, gather financial information and identify the problem, offer solutions for the client's review, develop a detailed plan for implementation of a solution to resolve their financial problem, and confirm that the solution fits the purpose. (CCP-75-01)

Consultants tell callers that they have helped thousands of clients in similar situations. Employees ask clients how much income they have coming in each month, how much their living expenses are (rent/utilities/telephone/food/etc) and how much is left that can be used to pay bills. Employees enter the responses to the income and expense questions on their computers. They advise that instead of clients paying individual creditors, they will only have one payment to pay creditors. They further advise that a debt management plan will pay the potential client's debts faster while eliminating interest payments and late fees and putting an end to harassing phone calls. Employees go down the list by creditor name, credit type (credit card/auto loan, secured/unsecured), total debt balances, whether current or late, and use creditor provided minimum balance tables to arrive at a proposed payment. Employees mail a Client Action Plan with an agreement document and an "Authorization to Release Information" document to the client to complete and mail back to the employee.

Education

In addition to its DMP activities, the organization engaged in nominal education and outreach presentations. In XXXXX and XXXXX organization did not have a coordinated educational workshop or seminar program. There were several presentations about the effects of financial crisis on homeowners conducted by XXXXX in XXXXX in XXXXX, XXXXX for the Homecomings program. In addition, XXXXX's Chief Executive Officer XXXXX XXXXX made presentations on dealing with debt crisis and fundamentals of budgeting and credit in March and April XXXXX in XXXXX, XXXXX and at a University of XXXXX campus on behalf of XXXXX. XXXXX indicated that "the XXXXX counselors were discouraged from conducting workshops in XXXXX as XXXXX management was concerned about the quality of any presentation." Also the staff participated in a conference at the local college for incoming students in XXXXX, but "no detailed records were maintained." Organization concentrated on one-on-one counseling and education in its offices and over the telephone from its call centers.

The following table illustrates a comparison of XXXXX activities to those of other exempt credit counseling organizations:

TAX-EXEMPT CREDIT COUNSELING ORGANIZATIONS

	XXXXX Alabama	Rev. Rul. 69-441 501(c)(3)	Rev. Rul. 65-229 501(c)(4)	XXXXX
Free Public Education	Yes: Major activity	Yes	No	Yes, Nominal
Free Individual Counseling	Yes: Major activity	Yes	Yes	Yes
Debt Management Plans	Yes: 12% of counselors' time	Yes	Yes	Yes
Fees for DMPs	Yes: nominal waived for hardship	No	Yes: nominal	Yes: waived for hardship
Amount of Revenue from Fees	Incidental amount	None	Minor: main support from Fair share and contributions	XXXXX - 43% XXXXX - 46% main support from Fair share
Public Support	Contributions from gov't, private found., & United Way	Some: amount not specified	Some: amount not specified	No, only fair share and enrolled clients
Community Board	60% from general public	All members represent the public	n/a	n/a - Board of Parent Reps. and Employee

Finances

Fair share payments from creditors represent the organization's primary income. Fair share payments ranged from 5 to 10 percent of amounts collected on the creditors behalf. Each creditor has a rate of payment based upon their DMP experience. XXXXX received fair share in two ways: (1) by deducting fair share from amounts collected and remitted to credit card companies and (2) by billing the credit card companies. It recognized uncollectible fair share billings as bad debt expense.

In XXXXX XXXXX earned revenues of \$ _____ in fair share representing **57 percent** of total XXXXX revenues of \$ _____. In XXXXX XXXXX earned revenues of \$ _____ in fair share representing **54 percent** of total XXXXX revenues of \$ _____.

The following Exhibit illustrates income and expenses reported on XXXXX Forms 990 and detail per Examination:

XXXXX XXXXX XXXXX XXXXX XXXXX

Form 886-A

	Form 990	Form 990	Form 990	Form 990	Exhibit I Form 990
Direct public support	0	0	0	0	0
Program service revenue					
Fair Share - from Creditors					
Processing fees - from Clients					
Enrollment fees - from Clients					
Other income * XXXXX	0	*		0	0
Total Revenue	<hr/>				
Compensation of Officers	0	0			
Salaries and Wages					
Service Bureau Expense					
Bad Debts	0	0			
Occupancy	0				
Telephone					
General and Administrative	0				
Other Expenses					
Total Expenses	<hr/>				
Excess or (Deficit)	<hr/>				
	=====				

Although XXXXX experienced annual financial losses, it continued to expand its activities to attract and retain DMPs, its collections on behalf of creditors, its contracting with the for-profit service provider XXXXX, and payment of service bureau fees.

When on a DMP, the client usually was required to pay a \$25 enrollment fee and a monthly maintenance fee for the service. The maintenance (processing) fee varied depending on the amount of the payments. It was generally based upon 6.5 – 8.0 percent of the payments and usually ranged from \$0 to \$35 per month. Of XXXXX Revenues, XXXXX received **43 percent** from clients with monthly maintenance of \$ and enrollment fees of \$. In XXXXX, XXXXX received **46 percent** in revenues with client maintenance of \$ and enrollment fees of \$.

More than an insubstantial part of XXXXX's activities was directed towards referring business to the for-profit service provider XXXXX, which was operated by XXXXX, Chief Financial Officer of XXXXX and Chief Operating Officer of XXXXX and as a wholly-owned subsidiary of the non-profit parent XXXXX, exempt under 501(c)(3).

Revenue Agent determined that XXXXX Service Bureau Expense of \$ included \$ paid to XXXXX and \$ paid in revenue sharing for XXXXX clients to XXXXX. Of XXXXX Revenues XXXXX paid **48 percent** to XXXXX. Revenue Agent determined that XXXXX Service Bureau Expense of \$ included \$ paid

to XXXXX and \$ paid in revenue sharing to XXXXX. Of XXXXX Revenues XXXXX paid 57 percent to XXXXX. The annual losses did not deter DMP enrollments with XXXXX.

In XXXXX and XXXXX, XXXXX and XXXXX were controlling officers of XXXXX and controlled XXXXX's and XXXXX's daily operations. XXXXX's officers XXXXX and XXXXX did not receive compensation directly from XXXXX. However, XXXXX's Forms 990 reported that XXXXX received salaries of \$ in XXXXX and \$ in XXXXX. XXXXX's Forms 990 reported that XXXXX received salaries of \$ in XXXXX and \$ in XXXXX. XXXXX also paid XXXXX equal amounts, which would result in compensation of XXXXX of \$ in XXXXX and \$ in XXXXX from both XXXXX and XXXXX.

Marketing and Advertisements

XXXXX engaged commercial practices to pursue revenues. It employed advertising, business methods, and pricing to attract and retain clients. XXXXX received calls from potential clients responding to advertising in a number of media including telephone book yellow page ads, newspapers, and websites. Most contacts with clients were by phone, e-mail, and U.S. mail. Some contacts also were made at offices through "walk-ins." XXXXX received referrals from XXXXX/XXXXX. XXXXX also purchased leads on behalf of all XXXXX branches, and XXXXX consultants were evaluated on "leads handled." XXXXX also paid for advertising in various media including telephone book yellow pages and newspapers in XXXXX.

A XXXXX telephone book yellow pages advertisement reads:

~ A Non-profit Agency ~ XXXXXX XXXXX ~ Call Now!
XXXXX, XXXXX.

XXXXX ~

Revenue Agent secured seven other samples of yellow pages advertisements for the XXXXX, XXXXX office, which contained very similar wording and consumer calls to action.

A XXXXX ad read:

Free consultation call XXXXX XXXXX.

A XXXXX XXXXX advertisement starting XXXXX read:

XXXXX. XXXXX or toll free XXXXX.

XXXXX advertised its services on its website, XXXXX. It also had two brochures, in which it advertised its services to the general public, a _____ and a _____ brochure. The brochures are used to generate client interest in its debt management program. In the brochure XXXXX claims: "XXXXX _____ program that helps the consumer consolidate all unsecured debt. We

Consultation/Screening

Very little active budgeting education or budgeting assistance was offered to the callers. Consultants gathered financial information to determine if individuals and the organization may benefit from their debt management services. Consultants listen, evaluate, and provide free advice, Client Action Plans, and possibly literature to callers who would not benefit from, or qualify for, a DMP including callers without sufficient ability to pay their debts after their living expenses.

XXXXX generally operated as follows: Contact with a potential client would be made by telephone or e-mail. There was no pre-screening of leads based upon education, income, or need to determine educational level or charitable class. Consultants would ask probing questions to identify the purpose of the call and the root of the individual's problems. Employee would counsel the individual, determine options, and offer solutions to their problem. If the individual were a good candidate, the call would result in an attempt to enroll the potential client in a Debt Management Plan. The employee would ask the person for information regarding income, expenses, and unsecured debts that the individual currently had. The employee would gather name, address, telephone number, social security number, date of birth, occupation, and employment information. The employee would then prepare a "Personal Information" worksheet and "Creditor and Proposal Summary," which contained such personal information and a list of all debts to be covered by the plan. The Creditor and Proposal Summary would list the creditor information, total debt, and proposed monthly payment.

On its XXXXX Form 990 XXXXX reported it "interviewed approximately 4,367 individuals" and 454 were enrolled in a DMP. On its XXXXX Form 990 XXXXX reported it "interviewed approximately 9,753 individuals" and 975 were enrolled in a DMP during the year.

XXXXX reported total clients under debt management at end of XXXXX was 758, and at end of XXXXX, total was 1,273.

Client Action Plans

Client Action Plans (CAPs) included a greeting and information related to the conversation with the individual caller. CAPs summarized the telephone conversation as follows”

.” It follows with boxes checked of the consultant’s perception of the individual’s situation and recommendation based upon the consultant’s understanding.

The choices for perception are as follows:

- | | |
|--|--|
| <input type="checkbox"/> Behind in unsecured debt | <input type="checkbox"/> Emergency or unexpected expense |
| <input type="checkbox"/> Reduction or loss of income | <input type="checkbox"/> Supplementing income with credit |
| <input type="checkbox"/> Family crisis/Personal crisis | <input type="checkbox"/> Behind on secured debt or utilities |
| <input type="checkbox"/> Other | |

The choices for consultant’s recommendation include the following:

- | | |
|---|---|
| <input type="checkbox"/> XXXXX – Debt Management Plan | <input type="checkbox"/> Prioritization of debts/finances |
| <input type="checkbox"/> Increase your income/reduce expenses | <input type="checkbox"/> Budgeting exercises |
| <input type="checkbox"/> Bankruptcy/Legal Counsel | <input type="checkbox"/> Educational course |
| <input type="checkbox"/> Self-administered plan | <input type="checkbox"/> Repayment plan for mortgage |
| <input type="checkbox"/> Referred to other service | <input type="checkbox"/> Pre-foreclosure/Short sale on mortgage |
| <input type="checkbox"/> Other | |

Self-Administered Plan or Bankruptcy

Revenue Agent found that organization often referred individuals with insufficient income to cover their living expenses to a self-administered plan or bankruptcy. However, those who had sufficient income to cover living expenses and some unsecured debts were generally referred to DMPs. It appears that the consultants gather financial information to determine if individuals may benefit from a DMP and would meet creditor specifications for acceptance to a DMP.

Client Action Plans were not widely used in XXXXX and XXXXX, however Revenue Agent obtained some samples with XXXXX dates. One CAP for XXXXX stated that perception of situation was Emergency or Unexpected expenses and Behind on secured debt or utilities. It stated “First step is to contact your landlord. Second step is to call the lease company that you have vehicle with and offer them a voluntary repossession. Third step is to call Qwest and request them to stop automatic payment and ask what they are willing to do as far as a payment plan. Fourth step would be to call me back after you get all of these priorities taken care of so we can assist you with all of your unsecured debts (personal loan, LOC, credit card).” Recommendation was Self-administered plan and Prioritization of debts/finances.

Exhibit I

Another CAP recommending a Δ Self-administered plan to XXXXX and XXXXX stated that their "current budget doesn't reflect that you have the resources to start paying down this debt." XXXXX "recommendation is to simply ignore the collector and continue to provide for your family." The consultants also "included some information that will likely help stop some of the collection efforts. When your husband finally gets a wage increase I would recommend that you contact me so we can review your situation again and determine the best plan to resolve the student loan."

A CAP with Δ Behind in unsecured debt and Δ Other: collection calls recommends a Δ Self-administered plan to XXXXX stated that "

Another CAP with Δ Behind in unsecured debt recommends a Δ Self-administered plan for XXXXX indicating "

A CAP for XXXXX for Δ Reduction or loss of income the counselor recommended Δ Bankruptcy/Legal Counsel and stated "

Debt Management Plans

Debt Management Plans (DMP) were marketed as providing benefits and a needed bill-paying service to clients. The recommendation for the debt management program as a solution advised the client that it would allow them to get control over their personal debts by reducing the payment and interest rates, and most importantly reduce the stress that their current financial situation was causing.

Based upon a review of some client information sheets, it does not appear that the amount of disposable income in the "budget worksheet" necessarily bore any relationship to the monthly payment required by the DMP; in one case available income was \$758 and proposed payment was \$135.00. In another case, the client's monthly available income after expenses of \$565.00 was barely able to cover the proposed monthly payment under the DMP in the amount of \$564.00.

Written Client Action Plans were not widely used in XXXXX and XXXXX, however Revenue Agent obtained some samples in XXXXX. One CAP indicated that a standard

Exhibit I

debt management plan would require only one payment per month, lower their interest, and provide the ability to rebuild their credit due to paying creditors as agreed. However it would not reduce their monthly payments, and they could not use credit while on this program. For example, XXXXX and XXXXX of XXXXX, XXXXX had a "

" The CAP stated "If you can afford your current payments of about \$6000 per month, this plan should work well for you if your goal is to pay off debt. If you cannot afford a \$6000 payment, there may be another alternative we can discuss that would require much more effort on your part but is capable of getting the payments down to about \$3000 per month." That CAP was signed by XXXXX XXXXX, an officer of XXXXX.

Another CAP recommending an XXXXX-Debt Management Plan and Budgeting exercises to XXXXX of XXXXX stated "

" The CAP provides Applicant's net income of \$300 and expenses of \$100 with \$200 available income and a proposed DMP payment of \$106. A Client Authorization Agreement indicated that XXXXX could retain \$8 (or \$350 over the term of this agreement) of a \$106 monthly payment for 8.1% of \$98 monthly payment on \$5,378 in debts. That CAP was signed by XXXXX, an officer of XXXXX.

XXXXX of XXXXX stated "

Another CAP for XXXXX and XXXXX without a "perception of your situation" box checked stated "

" It further had an "our recommendation for your situation" box checked XXXXX-Debt Management Plan. It stated "

Account Management

Upon receipt of a completed DMP client information packet, counselors updated lead tracking. Once a completed DMP packet was received, the counselor contacted the

client, confirmed their plans, and transitioned the client to Account Management personnel with XXXXX (XXXXX).

When a customer agreed to a DMP, the individual signed an Agreement, which provided for the monthly payments on the debt balances. It also provided for an additional 10 percent over disclosed balances for undisclosed debts and service fees.

If offered a DMP, the client usually was required to pay a \$25 enrollment fee and a monthly maintenance fee for the service. The maintenance (processing) fee varied depending on the amount of the payments. It was generally based upon 6.5 – 8.0 percent of the payments and usually ranged from \$0 to \$35 per month. The monthly payment made by the DMP client would ordinarily include a payment to each creditor plus a maintenance fee for the DMP service.

For example, in XXXXX, XXXXX and XXXXX agreed that XXXXX could retain \$ of their \$ monthly payment for 6.6% of \$ debt payment on \$ in debts. In XXXXX XXXXX, XXXXX agreed that XXXXX could retain \$10 of her \$ monthly payment for 8% of \$ monthly payment on \$ in debts.

In XXXXX XXXXX of XXXXX agreed to a monthly maintenance fee of \$ of his \$ monthly payment for 8.7% on \$ in debt payments on balances of \$ in debts. XXXXX's case was provided as an example of a XXXXX DMP client who achieved reduced interest rates and other savings through the DMP.

For individuals agreeing to a DMP, the maximum maintenance fee was determined based upon the state in which the clients reside. In XXXXX, XXXXX of XXXXX agreed that XXXXX could retain only \$ (XXXXX maximum) of his \$ monthly payment or 4.2% of \$ payment on \$ in debts. However, in 2003 XXXXX and XXXXX from XXXXX were required to pay a monthly charge of \$ of their \$ monthly payment for 6.8% of \$ debt payment. Their debts were approximately \$.

The organization contracted the for-profit service provider XXXXX (XXXXX) dba XXXXX for data processing services at a \$17 - \$18 monthly fee for each DMP client. XXXXX Service Bureau Expense of \$ included \$ paid to XXXXX. XXXXX Service Bureau Expense of \$ included \$ paid to XXXXX. With an annual service bureau cost of \$ per client for twelve (\$18) months, service bureau expenses of \$ for XXXXX and \$ for XXXXX indicate payment for 823 and 1,039 clients for twelve months in XXXXX and XXXXX, respectively.

Free Or Below Cost Services

While DMP services were not limited to low-income or the poor, some DMP clients had their fees waived. XXXXX indicated that XXXXX had 84 of 454 clients enrolled in DMPs at no charge in XXXXX, and 122 of 973 were enrolled at no charge in XXXXX. General ledger enrollment fee income indicates that at least 421 paid \$25 in XXXXX and at least

773 paid \$25 in XXXXX. also indicated that 95 of 454 DMP clients and 198 of 973 DMP clients did not pay for monthly services in XXXXX and XXXXX, respectively.

However, some seemingly "low-income" clients were required to pay enrollment fees and monthly maintenance charges. A long-term customer XXXXX with steady DMP activity ranging from XXXXX to XXXXX indicated monthly income of only \$, monthly expenses of \$, and \$ of available income and proposed DMP payment of \$. This DMP client had total debts of \$ and an agreed total of \$ was required to pay a monthly maintenance charge of \$18 of her \$ monthly payment. Her monthly maintenance charge was 8% of her monthly debt payment. case was provided as an example of a XXXXX DMP client who achieved reduced interest rates and other savings through the DMP.

XXXXX Client unable to pay Procedures (AMP-75-02) document discloses a system and instructions on criteria for Account Management to use for evaluating accounts in which clients are unable to afford or make the scheduled payments. There also appears to be a grant/refund or temporary loan for clients who are in "true need and through investigation and counseling determined to be a good risk and candidate for the successful completion of the DMP."

XXXXX management provided printouts of clients whose enrollment fees and/or maintenance fees were waived in XXXXX and XXXXX. The printouts showed that most individuals who enrolled with the fee waived also dropped from the DMPs. The most recent date dropped was in XXXXX.

XXXXX sometimes provided DMP services below its cost. For individuals agreeing to a DMP, XXXXX/XXXXX and XXXXX sometimes charged the individuals monthly maintenance fees less than the \$17 or \$18 per month paid on the XXXXX contracts. Also, some maintenance fees were waived, but XXXXX still paid XXXXX a monthly fee. In substance the creditors' fair share payments helped to pay the for-profit's service charges in violation with the credit card companies' requirement that fair share only be paid to organizations exempt under section 501(c)(3).

For example, a XXXXX Customer Authorization Agreement indicates a XXXXX/XXXXX client XXXXX agreed that XXXXX could retain \$13 of her \$173 monthly payment to XXXXX. Her debts were approximately \$. In XXXXX clients XXXXX and XXXXX agreed that XXXXX could retain \$ of \$ monthly payment to XXXXX. In February XXXXX client XXXXX agreed that XXXXX could retain \$ of \$ per month as compensation for administration of the program. Her debts were approximately \$. In these cases, the fair share revenues helped subsidize the monthly service charges of \$17 or \$18 per month paid on the XXXXX contracts.

Leased Employees

XXXXX regularly engaged 3-5 leased employees who performed consultations for XXXXX (hereinafter referred to as employees). In XXXXX and XXXXX, XXXXX

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engaged the services of XXXXX, XXXXX, XXXXX, XXXXX, XXXXX, XXXXX, XXXXX, XXXXX, and XXXXX. XXXXX, XXXXX, and XXXXX continue a working relationship with XXXXX as leased employees

Some employees have social service backgrounds. Most consultants stated that they did not have prior experience or training in the field of credit counseling prior to their employment with XXXXX or XXXXX. Advertisements for consultants indicate that good candidates have problem solving and communication skills and desire to help people in financial crisis as follows:

*Noted to run Sunday, XXXXX:
- XXXXX, (XXXXX)*

Fax XXXXX.

Employees were required to pass The Institute For Personal Finance counselor certification exam within eighteen months of hiring date as a consultant. Passage is now required within twelve months of commencing employment.

XXXXX's employees were trained to establish a clear purpose or motive for each consultation session, gather financial information and identify the problem, offer solutions for the client's review, develop a detailed plan for implementation of a solution to resolve their financial problem, and confirm that the solution fits the purpose. () Possible solutions include a self-administered plan, debt management program, personalized plan, and bankruptcy. () Consultant development compact disks (CDs) provide taped telephone calls with examples of questioning by the consultants. Some callers were interested in Debt Management Plans (DMPs) solely for reduced interest rates and payments, but the counselors were instructed to fully develop their financial situation and determine the best solution. They were told that creditors would not accept DMPs from individuals who have adequate cash flow and only want to reduce their interest rates, credit card fees, and payment amounts. The discussion leader stated on one call on a CD "We do not want to be signing up clients that do not qualify. Our fair share is based on people that qualify. This (DMP) is not a solution." Creditors determine DMP clients. Consultants were trained to put an emphasis on evaluation function, to find the root of the problem and find an effective (agreeable to the credit card companies/payers of fair share) solution. On another he stated "Putting the solution ahead of the problem invalidates the session."

The XXXXX training manual contains instructions for employees on its counseling model and a flow chart for counseling procedure. () The Manual contains instructions geared to enrolling individuals in DMPs, including assembling DMP packets and Client Action Plan with necessary educational information. Additional instructions

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state to provide non-DMP clients with specific educational information and referrals as is pertinent to the client's situation and include a step-by-step accounting of the solution in the Client Action Plan to be sent to the client. Consultants are also instructed to update lead tracking for follow-up. Consultants update lead tracking upon receipt of a completed DMP client information packet. Once a complete DMP client information packet is received, the contacts the client, confirms their plans, and transitions the client to Account Management personnel with XXXXX

Included in the Manual is "Counselor" position description (), "Counselor Call Evaluation Process ()," "Counseling Procedure ()," and "Counseling Performance & Compensation ()." "Counselor" position description requires a consultants to attain at least level two (of four) consulting skills consistently within the first six months of employment. In addition, it requires a "minimum of 30 new (DMP) clients enrolled per month." Current "Counseling Performance & Compensation" document requires a minimum of 100 Client Action Plans (CAPs) per month from leads, and every CAP must be presented to the client with contact information including e-mail, address, and telephone numbers. This ensures that all clients receive a documented overview of their situation with an action plan.

Employees were evaluated based upon consultation call evaluations, leads handled, availability to clients, schedule coverage, and retention of DMP clients. Employees were compensated based upon points awarded for the performance categories. Compensation may be adjusted up or down after three out of four consecutive ratings are achieved. Employees were required to enroll a minimum number of DMP accounts to keep their jobs.

E-mails from the Director of Counseling reflect revisions to "Counseling Performance & Compensation" documents and a continuing concern about the productivity of XXXXX employees and methods to measure quantity over quality of counseling sessions. Personnel Action Notices indicated warnings for failure to reach the minimum standard for clients signed onto DMPs for a month (30).

Consultation performance was measured and evaluated in five categories: "Counseling call evaluation ratings 40%; Leads handled 20%; Availability to counsel the client 20%; Schedule coverage 10%; and Client retention 10%." () Performance and compensation tabulations take the points given from the above categories. According to The "Counseling Performance" document () points awarded for the performance categories could result in advancement in compensation level. However, in order to advance from level to level the minimum number of signs (DMPs) must be achieved for that increased level.

The "Counseling Performance" document () provided the following compensation structure to employees:

\$45,000 level requires a minimum average of 45 signs per month

\$38,000 level requires a minimum average of 38 signs per month
\$30,000 level requires a minimum average of 30 signs per month

Example 2 states that if a consultant's score in the five categories was qualified for \$38,000 a year and the counselor was at the \$30,000 level and had an average number of 39 signs, they would advance to the compensation level of \$38,000. Example 1 stated that if a consultant's score in the five categories was qualified for \$38,000 a year and the consultant was at the \$30,000 level and had an average number of 36 signs, they would remain at the \$30,000 compensation level.

Compensation of consultants was geared toward increasing sales of DMPs. Some employees were eligible for overtime, but there were no bonuses or incentives offered.

LAW

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-1(d)(2), Income Tax Regulations.

The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

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

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279 (1945).

Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3). In *Better Business Bureau of*

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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 the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

An organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." *Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii)*. Prohibited private interests include those of unrelated third parties as well as insiders. *Christian Stewardship Assistance, Inc. v. Commissioner*, 70 T.C. 1037 (1978); *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." *Retired Teachers Legal Fund v. Commissioner*, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. *est of Hawaii v. Commissioner*, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the "est" body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations."

The Service has issued two rulings holding credit counseling organizations to be tax exempt. *Rev. Rul. 65-299*, 1965-2 C.B. 165, granted exemption to a 501(c)(4)

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organization whose purpose was to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been meeting with people in financial difficulties to "analyze the specific problems involved and counsel on the payment of their debts." The organization also advised applicants on proration and payment of debts, negotiated with creditors and set up debt repayment plans. It did not restrict its services to the needy. It made no charge for the counseling services, indicating they were separate from the debt repayment arrangements. It made "a nominal charge" for monthly prorating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions.

Rev. Rul. 69-441, 1969-2 C.B. 115, granted 501(c)(3) status to an organization with two functions: it educated the public on personal money management, using films, speakers, and publications, and provided individual counseling to "low-income individuals and families." As part of its counseling, it established budget plans, i.e., debt management plans, for some of its clients. The debt management services were provided without charge. The organization was supported by contributions primarily from creditors. By virtue of aiding exclusively low income people, without charge, as well as providing education to the public, the organization qualified for section 501(c)(3) status.

In the case of *Consumer Credit Counseling Service of Alabama, Inc. v. U.S.*, 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were "an integral part" of the agencies' counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies' principal functions, as only approximately 12 percent of the counselors' time was applied to debt management programs and the charge for the service was "nominal." The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. See also, *Credit Counseling Centers of Oklahoma, Inc. v. United States*, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in *Consumer Credit Counseling Centers of Alabama, Inc. v. United States*, discussed immediately above.

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

provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way.

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

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

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) 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, nor scientific, but rather commercial. The court found that the corporation had completely failed to demonstrate that its services were not in competition with commercial businesses. The court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was generated from services, and those fees were set high enough to recoup all projected costs, and to produce a profit. And finally, the corporation had failed to limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'd 12 Cl.Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the adoption activity was a non-exempt commercial purpose. It found that the adoption services did not further the exempt purposes of providing educational and charitable services to the unwed mothers and children. Rather, the services for unwed mothers and children were merely provided "incident" to the organization's adoption service business.

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

In *Church By Mail, Inc. v. Commissioner*, T.C. Memo 1984-349, *aff'd* 765 F. 2d 1387 (9th Cir. 1985) the tax court found that a church was operated with a substantial purpose of providing a market for an advertising and mailing company owned by the same people who controlled the church. The church argued that the contracts between the two were reasonable, but the Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church.

In *International Postgraduate Medical Foundation v. Commissioner*, T.C. Memo 1989-36, the court found an organization that ran tours aimed at doctors and their families was operated to benefit the private interests of both an individual who controlled the organization and a for-profit travel agency (H&C Tours) that handled all of its tour arrangements. The organization used the H&C Tours exclusively for all travel arrangements. There was no evidence that the organization solicited competitive bids from any travel agency for travel arrangements for its tours other than H&C Tours. The organization physically located its office within the offices of H&C Tours, which provided it secretarial, clerical, and administrative personnel for a fee equal to H&C Tours' costs. The organization spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The brochures emphasized the sightseeing and recreational component of the tours, but did not describe the medical curriculum for the seminars and symposia that was the basis for exemption. Educational activities occurred on less than one-half of the days on a typical tour. The court found that a substantial purpose of the organization's operations was to increase the income of H&C Tours. The president of H&C Tours controlled the organization and exercised that control for the benefit of H&C Tours and himself. Moreover, the administrative record supported the finding that the organization was formed to obtain customers for H&C Tours.

The court in *Redlands Surgical Services v. Commissioner*, 113 T.C. 47 (1999) stated that merely entering a partnership with private parties in which they receive a return on a capital investment does not impermissibly confer private benefit. However, a detailed examination of the Redlands surgery center venture convinced the court that the petitioner had ceded control to private parties having an independent economic interest in the activity and no obligation to promote charitable purposes ahead of profit making. Therefore, the applicant was not operated exclusively for exempt purposes. The Court

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pointed to the long-term management contract with a party related to the for-profit, with broad discretion, and a fee based upon gross revenue. Furthermore, the record did not show that the nonprofit had any role in negotiating the contract.

In Aid to Artisans v. Commissioner, 71 T.C. 202 (1978) all profits are earmarked for specific charitable purposes; Incorporated Trustees of the Gospel Worker Society, 510 F. Supp. 374 (D.D.C. 1981), aff'd without op. 672 F.2d 894 (D.C. Cir. 1981) The courts point that accumulation of large amounts of money, or payments of large amounts to insiders and outsiders, without using the money to further charitable goals is evidence of a non-exempt purpose.

The Credit Repair Organizations Act (CROA), 15 U.S.C. § 1679 et seq., effective April 1, 1997, imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. § 1679b. Significantly, section 501(c)(3) organizations are excluded from regulation under the CROA.

The CROA defines a credit repair organization as:

any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—

- (i) improving any consumer's credit record, credit history, or credit rating, or
- (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. § 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re: National Credit Management Group, LLC, 21 F. Supp. 2d 424, 458 (N.D.N.J. 1998).

EXEMPT ORGANIZATION'S POSITION

The exempt organization considers itself "the white hats" of the industry. XXXXX insists that its activities are in furtherance of a counseling and debt repayment program that restore financial balance to peoples' lives and further purposes described in section 501(c)(3) of the Internal Revenue Code.

However, organization has now merged with the XXXXX non-profit corporation XXXXX and considers itself terminated as of XXXXX. The organization had net liabilities at the end of the years under examination December 31, XXXXX and when it merged with the parent corporation XXXXX as of December 31, and terminated,

Revenue Agent sees an alternative position of termination as of December 31,

GOVERNMENT POSITION

XXXXX is not operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3) and its tax-exempt status of XXXXX should be revoked for failure to operate exclusively for 501(c)(3) purposes and for violating the prohibition on inurement as set forth in Internal Revenue Code section 501(c)(3).

XXXXX was not operated with public support and public control. It was controlled by XXXXX and XXXXX, principals of XXXXX and XXXXX, Inc. dba XXXXX. It was privately supported in aggregate by credit card companies with over 50 percent of its income in the form of fair share from credit card companies.

XXXXX is not engaged primarily in activities that accomplish an exempt purpose. It did not exclusively serve a charitable class such as low-income individuals. It did waive fees and provide some services free or below cost if a DMP was desirable to creditors. Organization operations have an inherently commercial nature and it provides services to any caller accepted by the creditors. If a caller has ability to pay, then services are provided at market rates allowed within the State of residence. It operated to serve a substantial non-exempt purpose.

The purpose of XXXXX's activities differs substantially from those of the organizations in Rev. Rul. 65-299, Rev. Rul. 69-441, and Consumer Credit Counseling Service of Alabama, Inc. v. U.S. In this case, XXXXX engages in minimal activities which further an exempt purpose. Its "counseling" activity is nothing more than an interviewing activity; XXXXX screens consumers to market and sell DMP services. There is very little education provided to consumers who contact, or are contacted by XXXXX from lead tracking. Employees were evaluated not on the ability to provide good education or counseling services to clients, but on their ability to identify the appropriate solution for their problem through mass screening. The evaluation of employees encouraged interviewing potential DMP candidates, producing the required 100 monthly or 300 quarterly client action plans, and signing and retaining 30 new DMP clients each month. Counselor compensation rewarded enrollments of consumers in DMPs and did not encourage any meaningful education or credit counseling to take place. The training manual reinforces this work environment by setting production goals for employees to produce 100 CAPs and enroll 30 new DMP clients per month. Unlike the credit counseling organizations described in the Revenue Rulings referred to above, and in Consumer Credit Counseling Service of Alabama, Inc. v. U.S., XXXXX provides very little counseling or education to its clients.

XXXXX did not engage in substantial educational outreach activity to community groups. The organization did not have the appropriate human resources for mass educational programs in XXXXX in XXXXX and XXXXX. XXXXX did not

have an educational budget or a coordinated educational workshop or seminar program. Presentations made on dealing with debt crisis and fundamentals of budgeting and credit were not supported by any agendas or other record of curriculum. The presentations about financial crisis for homeowners could also promote DMP services. There is no evidence that the group presentations did anything other than market the DMP product. In this case, we saw receipts of such magnitude paid out to for-profit organizations but very little going to further public purposes. In this context, the credit counseling organization budgeted no money for public educational activities, apart from advertising, and promoted non-exempt purposes. There is every indication that its activities were directed and its income was being used primarily for non-exempt purposes.

The reason XXXXX and the other exempt organizations which are part of the XXXXX enterprise are organized as exempt organizations is to avoid the regulatory scheme of the Credit Repair Organizations Act (CROA), 15 U.S.C. section 1679, et. seq. CROA was enacted to protect consumers by banning certain deceptive practices in the credit counseling industry. If XXXXX was a for-profit company, the CROA would prohibit it from charging fees in advance of fully providing services. Because section 501(c)(3) organizations are exempted from the provisions of CROA, XXXXX is able to engage in deceptive business practices that Congress intended to prohibit when it passed the CROA law. As such, XXXXX is operated for a substantial non-exempt purpose, that of carrying on a business while avoiding federal regulation. In addition, XXXXX could not collect "fair share" payments from creditors if it did not have exempt status. The entire DMP business depended on an organization having tax-exempt status.

XXXXX was operated for the purpose of serving a private benefit rather than public interests. The "common enterprise" of XXXXX, XXXXX dba XXXXX, and other exempt organizations which had fulfillment agreements with XXXXX, Inc. dba XXXXX was formed for the private benefit of XXXXX and first XXXXX (who sold his interests to XXXXX and agreed to not compete) and later XXXXX as highly compensated Chief Operating Officer. Once the client was enrolled in a DMP, all of the processing of that client's DMP was turned over to XXXXX dba XXXXX. XXXXX provided a steady stream of business to XXXXX, and XXXXX had complete control over the enrolled DMPs. XXXXX collected debtor payments, including processing fees, and disbursed payments to creditors. XXXXX dictated the per client charges regardless of the exempt organization's ability to pay. XXXXX did not solicit any companies other than XXXXX to process its DMPs even though it operated with annual losses. XXXXX has a substantial non-exempt purpose of signing up clients for DMPs to provide business to XXXXX dba XXXXX.

More than an insubstantial part of XXXXX's activities are in furtherance of a non-exempt purpose. It was also operated in competition with commercial businesses using advertising, pricing, and business methods. XXXXX has a substantial non-exempt purpose of signing up clients for DMPs to provide revenue collection services for credit card companies and other unsecured creditors. XXXXX is not furthering any charitable or educational purpose when it interviews

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consumers or screens DMP candidates to find DMPs acceptable to the creditors. To receive fair share payments, the organization fit into a system created to serve the creditors. If a client's credit score was too high, then the DMP would be rejected by creditors because organization would compete with the creditors for income on collectible accounts. XXXXX was operated in competition with commercial businesses. It advertised and obtained leads to increase its revenues and evaluated employees on their production similar to business methods of evaluation. Its employees were compensated based on the amount of DMP business they brought in and retained, and were threatened with being fired for insufficient DMP business. They were trained to select DMP consumers that they could retain to increase the organization's fair share revenues.

The activities were not directed to benefit the public, but rather private interests of XXXXX dba XXXXX and credit card companies.

The net earnings of XXXXX inured to the benefit of XXXXX and XXXXX in the form of executive compensation paid through service bureau fees and added market value in XXXXX's stock in XXXXX sold to XXXXX.

CONCLUSION

In summary, XXXXX was not operated exclusively for exempt purposes, because it did not engage primarily in activities that accomplish an exempt purpose. More than an insubstantial part of XXXXX's activities are in furtherance of a non-exempt purpose. XXXXX was operated for the purpose of serving a private benefit rather than public interests, and a part of the net earnings of XXXXX inured to the benefit of XXXXX and XXXXX, private individuals who are officers of the corporation.

Accordingly, it is determined that XXXXX is not an organization described in section 501(c)(3), and is not exempt from income tax under section 501(c)(3), effective XXXXX, XXXXX the beginning of the years under examination.