



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Release Number: **201143023**  
Release Date: 10/28/2011  
Date: August 3, 2011  
UIL Code: 501.03-30  
501.32-00  
501.33-00

Contact Person:  
Identification Number:  
Contact Number:  
Employer Identification Number:  
Form Required To Be Filed:  
Tax Years:

Dear

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

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

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

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

Letter 4038 (CG) (11-2005)  
Catalog Number 47632S

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

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

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



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Date: June 6, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

UIL #;s

501.03-30

501.32-00

501.33-00

Legend:

C = State

D = Date

E = Program #1

F = Program #2

G = Mentoring Program

H = Foundation

Dear

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

Facts

You were founded by operators of for-profit businesses engaged in investment, rehabbing, rental, sale and management of foreclosed properties. The initial application indicated you are an organization that provides foreclosure and financial counseling services. You were incorporated on D as a non-profit corporation under C law. Your Articles of Incorporation and Bylaws both state your purpose is:

- i. To provide educational services that foster financial responsibility and accountability;
- ii. To foster descent (sic) affordable housing for low- and moderate- income persons, veterans, persons with disabilities, the aging, and the like;
- iii. To provide services that promote cultural awareness, intergenerational interaction, fosters independence and promotes a general sense of health and well-being;
- iv. To solicit and receive contributions, purchase, own and sell real and personal property, to make contracts, to invest corporate funds, to spend corporate funds for the corporate

purposes, and to engage in any activity "in furtherance of, incidental to, or connected with any of the other purposes."

Your Form 1023 provided a breakdown of your organization's projected activities and indicated the percentage of time spent conducting each as follows:

- (40%) Housing Counseling, Home Owner Education and Financial Literacy
- (10%) Group Foreclosure Workshops
- (20%) Environmentally Friendly Affordable Homeownership
- (20%) Needed Services for Foreclosure Victims
- (10%) Fundraising

Initially you will concentrate on housing and foreclosure counseling. The provision of environmentally friendly affordable homeownership will be a future activity.

The housing counseling, home owner education and financial literacy will consist of helping individuals maintain home ownership by providing financial education, budgeting strategies, mortgage workout resolutions, financial assistance and foreclosure prevention strategies. Before beginning each counseling session, each participant completes an input sheet to document their information, personal situation and financial status. Both telephone consultations and face-to-face counseling will be conducted. Workshops will be conducted by bank representatives, CPA contracted counseling agencies and HUD certified counselors at local libraries, conference rooms and your local offices on a weekly basis. You will use materials from the E to educate regarding lender negotiation and workout assistance.

Program #1 focuses on clients in foreclosure or pre-foreclosure. The process is as follows:

- Homeowner meets with counselor
- Default case is determined
- Servicer information is requested and reviewed
- Homeowner situation is analyzed
- A budget is developed
- Home value is determined
- It is determined if the situation is curable
- Loan mitigation tools and options are determined
- Workout plan is developed
- Loan mitigation package is submitted
- Client is educated regarding servicer negotiation
- Servicer negotiation support is provided
- Workout solutions may include loan modifications, forbearances, repayment plans, short sales or a deed in lieu.

You will receive no fees from lenders.

Group foreclosure workshops will be conducted for small groups at local libraries, available conference rooms and your office. The students will be taught basic financial literacy including financial and credit terms, budgeting strategies, the importance of tracking and maintaining positive

credit rating, the foreclosure process, and various methods and procedures of foreclosure prevention and financial stability.

Your environmentally friendly affordable homeownership will increase the supply of low-income housing by upgrading existing homes and/or building new ones. The housing will target the elderly, handicapped, veterans and those in service fields (firefighters, teachers, police, etc...). The housing will be made available exclusively to low-income individuals and will comply with the guidelines set forth in Revenue Procedure 96-32.

Needed services will assist individuals and families in obtaining needed resources after a foreclosure such as shelter and counseling.

Additional details regarding your services were provided. You will utilize F, which helps adults enhance their money skills and create positive banking relationships. This program will be targeted to low and middle income individuals who are working, may be "unbanked" or underserved and have very little financial knowledge.

Each client will receive an Individual Counseling Plan (ICP). The ICP will outline the client's objectives, and outline action steps needed for each component of the ICP, and a timeline for completion of goals. With each objective completion, a Certificate of Completion will be issued to the client. At the end of your services each client will receive an assessment and follow up services will be provided on a case by case basis.

Housing counseling services will be provided in the following areas:

- Pre-purchase homebuyer counseling
- Homebuyer education programs
- Counseling to resolve or prevent mortgage delinquency or default
- Non-delinquency, post-purchase counseling on improving mortgage term, HUD's home equity conversion mortgage program (HECM) and home improvement
- Post-purchase education programs
- Counseling and education on locating, securing, or maintaining residence in rental housing
- Counseling on shelter or services for the homeless
- Marketing and outreach initiatives
- Homeownership voucher counseling

Your services will be marketed through apartment magazines, newsletters, television ads and word of mouth. All of your programs will be open to the public. In the future fees may be charged to clients based on a sliding scale determined by income utilizing the Federal Poverty Guidelines. No fee would be charged for household incomes less than 80% of median income (AMI).

Initially, your board of directors was described as consisting of five individuals. Two of the five are related (father and son). Two of the five will become certified as housing counselors and will be compensated.

The financial information submitted with your Form 1023 projected all revenue from donations in your first three years of operations. Expenses were projected to equal revenue. The three largest

projected expenses were program expenses, director/officer compensation and other salary and wages.

Your responses to our questions regarding your application provided the following clarifications and substantial changes to your projected operations.

#### 1<sup>st</sup> response

You will have only three directors. None are related or compensated. The individuals projected to receive compensation are identified as "Co Executive Directors", are not voting board members and are currently not compensated.

You will not provide housing counseling using E. Instead, you will "collaborate with presently HUD approved agency(ies) allowing for better utilization of services". Mortgage mitigation services will also be in collaboration with a HUD approved agency.

You have not begun operations. You have no facility and have not purchased any housing. Anyone seeking credit repair, credit counseling, creditor negotiation or bankruptcy counseling will be referred to a local non profit agency.

The "Needed Services for Foreclosure Victims", listed among your activities, involve referrals to a non-profit agency that can address their needs.

An application to H.U.D. for the Neighborhood Stabilization, E, found on the web site and verified in the response, indicates you will purchase, develop and rehabilitate homes for low and moderate income buyers.

#### 2<sup>nd</sup> response

You explained your collaboration process and identified the existing four non-profits that will receive referrals. You revised your projected activities. The new breakdown of the activities is as follows:

- (50%) Housing acquisition and rehab
- (20%) Affordable rental housing
- (10%) Low-income rent-to-own housing
- (10%) Affordable housing ownership
- (10%) Fundraising

You will not provide credit counseling or foreclosure prevention education. If an individual expresses a desire for such counseling or education you will refer them to existing non-profit agencies. Regarding your housing, down payment assistance will be provided.

#### 3<sup>rd</sup> response

You clarified that each collaborating non-profit is a 501(c)(3) entity and no director or relative of a director will be involved in a rehabilitation project. You may be involved in a purchase & lease back program. All such properties will be "affordable housing".

Down payment assistance only applies to units owned by you (which are none at the present time). Seller financing may be an option for applicants who may not qualify for traditional mortgages. You will assist each client in exploring their options which may include connecting them with a C Housing Finance Agency "Preferred Loan Officer" (A listing of 16 individuals in your county who are recommended by C).

The down payment assistance is awarded based on performance. For each month a rental client pays on time they are awarded a credit of 10% of the payment to use as a future down payment. Also, the client can make an additional rent payment. A credit of 150% of the payment will be made to their down payment account.

You again stated that eligibility for your programs will be based on the guidelines established by Revenue Procedure 96-32. It is planned that the homes sold will be offered slightly below FMV so that the buyer will start with equity in the home.

#### 4<sup>th</sup> response

You provided further details regarding your down payment assistance program and indicated you would follow the guidelines established in Revenue Ruling 2006-27 situation 1.

#### 5<sup>th</sup> response

Your first response indicated you would not conduct housing counseling or mortgage mitigation but would collaborate with presently HUD approved agencies. However, a review of your web site indicated you were still offering housing counseling and/or mortgage mitigation. When asked to explain, you stated that you would change your website after the "question and answer clarification period" with the IRS.

Your articles and bylaws state, in part, that you will "prevent foreclosure". When asked if you intended to amend your articles in light of the stated changes in your projected activities, you stated that the bylaws would be amended. However, you pointed out that through the services you offer, you are, in part, "preventing foreclosure". The service provided IS the referral. Referrals are made to the previously described not for profit organizations. You clarified that "other" down payments refer to referrals only. No fees or other income will be derived by you for any referral.

In response to our questions regarding your participation in a "consortium" with three non-profit organizations you stated that the "consortium" came together to apply for HUD NSP2 funding. However, you are no longer part of this "consortium" because it "never became a reality as NSP2 funding was not awarded" and the "consortium" is dissolved.

#### 6<sup>th</sup> response

This response refused to respond to our additional questions. You stated that "our frustration grows and we question if there is ever going to be an end to this process". You requested exemption be granted based on the information submitted and compliance with our process.

### 7<sup>th</sup> response

You stated that the board member that is a grant writer will not write grants but will assist in the review process and that no board member would be compensated.

Regarding compensation issues, the "board will follow protocol as outlined in the conflict of interest statement as it has in the past where that member of the voting board is asked to leave the room during a vote that may involve a conflict. Therefore that member's vote is not considered."

You stated that your two directors who have experience rehabbing and selling foreclosed properties for profit "are making arrangements to scale back and cease operations in the existing for-profit business". Once you are "operational with the tax exempt status, focus will be shifted to developing plans to work on community projects through the non-profit entity".

You stated that you have no current relationships with for-profit entities. You are "looking to source all services from local vendors on a competitive bid process and adhere to the Conflict of Interest Policy in place".

You will not purchase or rehab any properties owned by your directors. Title to any properties will be held by you as beneficiary and one or more of your board members as the trustee.

One of your directors has started seven businesses. Four are no longer owned or operated by this individual. One has not conducted business since 2008. The other two entities, an investment firm dealing mainly in rehab and rental or properties and a management company involved in rehab, rental and property management were both scheduled to be dissolved in 2010. No evidence was submitted indicating the entities had been dissolved.

One of your purposes is to refer individuals to the for-profit G. You stated that it is a mentoring program that can teach individuals a means to make a living or develop a business through investing in real estate. The program is "just an option for those that are interested to get involved in a business opportunity that could later support them and/or their family". The program "will only be presented as an option and not a direction and (it is) left up to their discretion if they proceed or not".

You may receive grants from H to allow your clients to attend G. The wife of the founder of G is a director of H.

### Law

Section 501(a) of the Code provides that an organization described in section 501(c)(3) shall be exempt from taxation.

Section 501(c)(3) of the Code provides that corporations may be exempted from tax if they are organized and operated exclusively for charitable or educational purposes and no part of their net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An



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

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

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

Section 501(q) of the Code provides that organizations which provide "credit counseling services" as a substantial purpose shall not be exempt from taxation under section 501(a) unless they are described in sections 501(c)(3) or 501(c)(4) and they are organized and operated in accordance with the following requirements:

(A) The organization--

- (i) provides credit counseling services tailored to the specific needs and circumstances of consumers,
- (ii) makes no loans to debtors (other than loans with no fees or interest) and does not negotiate the making of loans on behalf of debtors,
- (iii) provides services for the purpose of improving a consumer's credit record, credit history, or credit rating only to the extent that such services are incidental to providing credit counseling services, and
- (iv) does not charge any separately stated fee for services for the purpose of improving any consumer's credit record, credit history, or credit rating.

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

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

- (i) requires that any fees charged to a consumer for services are reasonable,
- (ii) allows for the waiver of fees if the consumer is unable to pay, and
- (iii) except to the extent allowed by State law, prohibits charging any fee based in whole or in part on a percentage of the consumer's debt, the consumer's payments to be made pursuant to a debt management plan, or the projected or actual savings to the consumer resulting from enrolling in a debt management plan.

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

- (i) which is controlled by persons who represent the broad interests of the public, such as public officials acting in their capacities as such, persons having special knowledge or expertise in credit or financial education, and community leaders,
- (ii) not more than 20 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the

repayment of consumer debt to creditors other than the credit counseling organization or its affiliates), and

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

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

Rev. Rul. 61-170, 1961-2 C.B. 112, held that a nurses' association which maintains an employment registry primarily for the employment of members is not entitled to exemption as a charitable organization under IRC section 501(c)(3).

In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service found that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code. Its board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions. By aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and beneficial to the community. Thus, the organization was exempt under section 501(c)(3) of the Code.

Rev. Rul. 2006-27; 2006-1 C.B. 915, considered, in part, three situations where organizations that otherwise meet the requirements of IRC section 501(c)(3), provide down payment assistance to home buyers, to determine if they operate exclusively for charitable purposes. The revenue ruling held that in situations 1 and 3 the organizations were operated exclusively for section 501(c)(3) purposes, and in situation 2, the organization was not operated exclusively for section 501(c)(3) purposes. Distinguishing factors for disqualification in situation 2 included:

- To finance its down payment assistance program, the organization relied upon sellers and other real estate related businesses that could benefit from the transaction.
- The organization's staff knew the identity of the home seller or other interested party.
- The payment from the home seller corresponded to the amount of the down payment.
- The organization relied on these payments for most of its funding.

The analysis concluded that the business purpose of this service was the primary goal, which overshadowed any educational or charitable purpose.

Rev. Proc. 96-32; 1996-1 C.B. 717; This revenue procedure sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable as described in IRC section 501(c)(3) because they relieve the poor and distressed as described in section 1.501(c)(3)-1 (d) (2) of the Income Tax Regulations. This revenue procedure also describes the facts and

circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed such that they will be considered charitable organizations described in section 501(c)(3). It also clarifies that housing organizations may rely on other charitable purposes to qualify for recognition of exemption from federal income tax as organizations described in section 501(c)(3).

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

Old Dominion Box Co. v. United States, 477 F. 2d 340 (4th Cir. 1973), cert. denied 413 U.S. 910 (1973) found that operating for the benefit of private parties constitutes a substantial nonexempt purpose.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services did not satisfy the operational test under section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of typical section 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, while to some extent the fees charged reflected ability to pay, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978), the court held that an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational. The Consumer Credit Counseling Service of Alabama was an umbrella organization made up of numerous credit counseling service agencies. These agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they did provide such services free of charge. As an adjunct to the counseling function, they offered a debt management plan. Approximately 12 percent of a professional counselor's time was applied to the debt management plan as opposed to education. The agencies charged a nominal fee of up to \$10 per month for the debt management plan. This fee was waived in instances when payment of the fee would work a financial hardship.

The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. As such, the community and education counseling assistance programs were the agencies' primary activities. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way. An incidental amount of their revenue was from service fees. Thus, the court concluded that "each of the plaintiff consumer credit counseling

agencies was an organization described in section 501(c)(3) as a charitable and educational organization." See *also*, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts were virtually identical and the law was identical to those in Consumer Credit Counseling Service of Alabama, Inc. v. United States, discussed immediately above.

In Church by Mail, 765 F. 2d 1387 (9<sup>th</sup> Cir. 1985), affg. TCM 1984-349, Tax Court concluded that the extent of the integration between the operations of a non-profit entity and related for-profit entities controlled by the non-profit directors precluded exemption. Furthermore, the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9<sup>th</sup> Circuit Court of Appeals, in affirming the Tax Court's decision, stated 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 Easter House v. United States, 12 Cl. Ct. 476 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988) cert. denied, 488 U.S. 907, 109 S. Ct. 257, 102 L. Ed. 2d 246 (1988), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. The court concluded that its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court found that the health-related services were merely incidental to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3).

In International Postgraduate Medical Foundation v. Commissioner, T.C.M. 1989-36, the court held that an organization that had the substantial nonexempt purpose of benefiting a related for-profit travel agency, from which it purchased travel services, did not qualify for exemption under IRC 501(c)(3).

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

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in

which this organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for an exempt purpose. As the court stated:

Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia*, whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.

In Solution Plus, Inc. v. Commissioner, T.C. Memo. 2008-21, the Tax Court held that a credit counseling organization was not exempt under section 501(c)(3) because it was not organized and operated exclusively for educational or charitable purposes and impermissibly served private interests. The organization was formed by an individual with experience selling debt management plans ("DMPs"). The founder and his spouse were the only members of the organization's board of directors. The organization did not have any meaningful educational program or materials to provide to people who contacted the organization, and its financial education seminars for students constituted an insignificant part of the organization's overall activities. The Court held that the organization's purposes were not educational because its "activities are primarily structured to market, determine eligibility for, and enroll individuals in DMPs." Its purposes are not to inform consumers "about understanding the cause of, and devising personal solutions to, consumers' financial problems," or "to consider the particular knowledge of individual callers about managing their personal finances." The Tax Court also held that the organization's purposes were not charitable because "[its] potential customers are not members of a [charitable] class that are benefited in a 'non-select manner' \* \* \* because they will be turned away unless they meet the criteria of the participating creditors."

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

### **Analysis**

Section 501(c)(3) of the Code sets forth two main tests for an organization to be recognized as exempt. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). You fail the operational test. You are not operated exclusively for charitable purposes. Your operations also indicate that you have a substantial non-exempt, commercial, purpose. In addition, your operations have the effect of serving private rather than public interests. Finally, as an organization providing financial counseling, you are not in compliance with the requirements of IRC section 501(q).

## Operational Test

To satisfy the IRC section 501(c)(3) operational test, an organization must establish that it is operated exclusively for one or more exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. As further clarified by the U. S. Tax Court in the B.S.W. Group decision, under the operational test, the purpose towards which an organization's activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a section 501(c)(3) organization. Your activities are not directed exclusively toward one or more exempt purposes.

Your activities demonstrate that you do not operate exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. Initially you stated your primary purpose (70% of activity) would involve financial counseling. Only 20% of your activity would be the provision of housing and the other 10% was fundraising. You did not provide evidence that the initial financial counseling served exclusively charitable purposes.

During the processing of your application you substantially modified your activities. The new breakdown of the activities is as follows:

- (50%) Housing acquisition and rehab
- (20%) Affordable rental housing
- (10%) Low-income rent-to-own housing
- (10%) Affordable housing ownership
- (10%) Fundraising

However, a review of your web site indicated you were still offering housing counseling and/or mortgage mitigation. You stated that you would change your website after the "question and answer clarification period" with the IRS. However, to date, no changes have been made. Furthermore, your articles and bylaws state, in part, that you will "prevent foreclosure". When asked if you intended to amend your articles in light of the stated changes in your projected activities, you stated the bylaws would be amended in the future. This reluctance to make changes to your website, articles and bylaws calls into question the validity of the revision of your activities.

You stated that in the future fees may be charged to clients based on a sliding scale determined by income utilizing the Federal Poverty Guidelines. Therefore, your services will not be free and will not be limited to any charitable class. You will help people of all income levels. Helping people of all incomes does not provide relief to the poor and distressed within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations or serve any other purpose recognized as charitable. Accordingly, you are unlike the organization described in Rev. Rul. 69-441, supra, which aided low-income individuals and families who have financial problems, thereby relieving the poor and distressed. Since you have indicated that you may charge fees for the majority of services provided, you are also unlike the organizations in Consumer Credit Counseling Service of Alabama. Although these organizations did not limit services to low income individuals, services were provided free of charge. Rather, you are similar to the organization addressed by the Solution Plus Tax Court Memo, which held that the organization's purposes were not charitable because the "potential customers are not members of a charitable class that are benefited in a 'non-select manner'", and

that “primarily providing services for a fee ordinarily does not further charitable purposes.

Even considering your revised activities, you have failed to establish your provision of housing will be exclusively charitable. You failed to submit the required housing schedule required by Form 1023 or give sufficient details for us to conclude your housing activity was exclusively charitable. For example, you indicated your housing will target the elderly, handicapped, veterans and those in service fields (firefighters, teachers, police, etc...) but will be made available exclusively to low-income individuals and will comply with the guidelines set forth in Revenue Procedure 96-32. Elderly and handicapped citizens have specific needs that you failed to prove you will address. Also, you did not make clear how employed firefighters, teachers, police, etc... would be considered “low-income”. You have not demonstrated that the provision of these services exclusively furthers charitable purposes within the meaning of section 501(c)(3) of the Code. Therefore, you also have not met the requirements of section 1.501(c)(3)-1(d)(ii) of the Regulations, which assigns the burden of proof to an applicant organization to demonstrate that it meets the operational test.

#### Commerciality - Substantial Nonexempt Purpose

Section 1.501(c)(3)-1(c)(1) of the regulations provides an organization does not qualify for exemption if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. A nonexempt purpose may be evidenced by activities that are conducted in a commercial manner or for a commercial purpose. Indeed, in discerning whether an organization has a substantial nonexempt commercial purpose, courts focus on a number of factors related to the nature of the activities and how an organization conducts its business, including pricing policies, funding sources, and the organization’s competitiveness with and similarity to other commercial ventures. [Several court decisions have established commerciality as a disqualifying substantial non-exempt purpose. e.g., B.S.W. Group, 70 T.C. 352 (1978); Easter House, 12 Cl. Ct. 476 (1987); Airlie Foundation, 283 F. Supp. 2d 58 (D.D.C. 2003); Living Faith, 950 F.2d 365 (7th Cir. 1991).]

You are similar to the organization described in B.S.W. Group, Inc., which did not satisfy the operational test under IRC 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”. You have indicated that after exemption is received, your website will be changed to reflect your new activities. You also have indicated that related for-profit entities, owned by your director, that conduct similar housing activity, will be dissolved. When asked if your two directors who have experience rehabbing and selling foreclosed properties for profit will continue this activity, you stated that the “directors referenced here are making arrangements to scale back and cease operations in the existing for-profit business”. Once you are “operational with the tax exempt status, focus will be shifted to developing plans to work on community projects through the non-profit entity”.

Based on the information you have provided, not possible future changes, you are not in compliance with section 1.501(c)(3)-1(d)(1)(ii) of the regulations which assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and, specifically, that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. The interrelationships and common control of your organization and the for-profit entities is a substantial non-exempt purpose similar to the operations of the organizations in International Postgraduate Medical Foundation v.

Commissioner and Old Dominion Box Co. v. United States. Your existing relationship with the commonly controlled for-profit entities also constitutes a specific non-exempt purpose which precludes exemption consistent with the decision in Better Business Bureau of Washington, D.C., Inc. v. United States.

It is unnecessary for us to determine that you will make payments to the related for-profit entities or that such payments will be unreasonable. As the court indicated in Church by Mail, "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." Your entire enterprise is carried on in such a manner as to substantially benefit the related for-profit entities operated by your directors.

You conduct many of your activities, which are normally carried on by commercial enterprises for a profit, in the same commercial manner and in direct competition with commercial businesses, as the organizations in Airlie Foundation v. Commissioner and Easter House v. United States, as well as Living Faith v. Commissioner, where courts have found that a substantial non-exempt commercial purpose precluded qualification for tax-exemption under IRC section 501(c)(3). The housing activity you plan to provide is in direct competition with for-profit entities that provide similar services. In fact, your director owns two such for-profit entities. Based on the facts as described above, you will conduct the same activities previously conducted by your directors through their for-profit enterprises and simply shift projects through to you. You have not substantiated how the shift to you will vary from commercial operations. You have failed to provide evidence that you will ensure charitable goals take precedence over the interests of related and unrelated for-profit entities. Although you agreed to comply with the guidelines of Rev. Proc. 96-32, no supporting documentation, contracts or other agreements were submitted showing how you plan to implement and oversee compliance.

You stated that you have no current relationships with for-profit entities. You are "looking to source all services from local vendors on a competitive bid process and adhere to the Conflict of Interest Policy in place". This is evidence you plan to have relationships with for-profit entities but failed to provide details by indicating "no current relationships".

More than an insubstantial part of your activities are in furtherance of a nonexempt commercial purpose, in contravention of section 1.501(c)(3)-1(c)(1) of the regulations. Therefore, you are not operated for an exempt purpose.

#### Private Benefit

As stated in IRC section 501(c)(3) and section 1.501(c)(3)-1(d)(1)(ii) of the regulations - An organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

You are controlled by a board of directors composed of real estate professionals, without public participation of any kind. This is similar to the situation described in Rev. Rul. 61-170, where the general public benefit was only incidental. Your board of directors is composed primarily of persons who stand to gain financially from your organization's activities, unlike the organization in Rev. Rul.



69-441, whose board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

Two of your directors own for-profit entities that conduct similar operations. You have not provided evidence that your non-public board would not use its position to directly benefit the related for-profit entities. In addition, you have indicated that one of your purposes is to refer, to a for-profit mentoring program, G, individuals desiring to become involved in the real estate business. The referral of your clients is a direct private benefit to the for-profit entity. Both of these benefits to related for-profit entities are similar to the single non-exempt purpose which precluded exemption for the applicant organization in Better Business Bureau of Washington, D.C., Inc. v. United States. Therefore, you have not demonstrated that your operations serve a public rather than a private interest as required by section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

### Section 501(q) of the Code

An organization that provides educational information on financial topics or financial counseling to homeowners who are at risk of foreclosure is providing "credit counseling services" within the meaning of section 501(q)(4)(A) of the Code. An organization that engages in such activities as a substantial purpose must, in addition to complying with the requirements of section 501(c)(3), comply with the provisions of section 501(q).

Initially your primary activity was financial counseling. However, after your stated projected activity revisions, your primary activity will be housing. It is unclear if your revised activities contain a substantial counseling component. Your bylaws indicate you will "prevent foreclosure". When asked about this you indicated that:

In the programs we have described and services we are seeking to offer, we promote and provide affordable housing and affordable rents and provide resources to secure appropriate and necessary funding. Part of providing the housing includes working with the individual to provide the resources and tools that will assist them in attaining home ownership as well as reducing their risk of "losing their home" – i.e. Foreclosure. We are, in part, "preventing foreclosure", when we provide the individual with options of whom they can meet with, and if asked by said individual, [we] assist in connecting them to a collaborating organization (of their choosing).

While you claim that this is simply a referral process, you will work with the individual to provide the resources and tools and inform them of their options. This could be considered counseling. Section 501(q)(4)(A) of the Code defines, for purposes of section 501(q), the term "credit counseling services" to mean (i) the providing of educational information to the general public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of consumer credit; (ii) the assisting of individuals and families with financial problems by providing them with counseling; or (iii) a combination of the activities described above.

Therefore, whether you primarily provide counseling or housing, it appears you will provide "credit counseling services" as defined by section 501(q)(4)(A) of the Code.

As provided in section 501(q)(1)(D) of the Code, credit counseling organizations must be governed by a board controlled by persons representing the broad interests of the public rather than by

persons who benefit from the organization's activities. You have provided no evidence your board represents the broad interests of the public. Rather, it appears to serve private interests.

You initially indicated that your two Co-Executive Directors would be compensated. Currently you have no paid directors or employees. In your application and correspondence the individuals projected to receive compensation are identified as "Co-Executive Directors". Although you state that the Co-Executive Directors do not have voting power, you have not fully explained the duties and roles of the Co-Executive Directors. The presence of "director" in the title conveys an expectation that the two Co-Executive Directors would be part of the governing body. If so, this would not comply with section 501(q)(d)(ii), which states that at all times the organization must have a board of directors or other governing body not more than 20 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the repayment of consumer debt to creditors other than the credit counseling organization or its affiliates).

Accordingly, you do not have a board that is controlled by persons who represent the broad interests of the public as required by section 501(q)(1)(D)(i). You also appear to fail the requirements of sections 501(q)(1)(D)(ii) and (iii), which specify that the percentage of voting power that is allowed to be vested in financially interested persons is no more than 20%.

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

### **Conclusion**

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

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

### **Appeal Rights**

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

Your protest statement should be accompanied by the following declaration:

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

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

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

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

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

Mail to:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

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

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

Sincerely,

Lois Lerner  
Director, Exempt Organizations

Enclosure: Pub. 892