



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201213031**
Release Date: 3/30/2012
Date: January 6, 2012
UIL Code: 501.32-00
501.32-01
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.

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

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

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

Sincerely,

Lois 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: November 9, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = date
C = state
D = individual
E = individual
F = individual
G = business
H = business
J = individual
K = state fund
L = business
m = number
n = dollar amount
p = dollar amount
q = dollar amount
r = dollar amount
s = dollar amount
t = year

UIL:

501.32-00
501.32-01
501.33-00

Dear

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

Letter 4036(CG) (11-2005)
Catalog Number 47630W

Issues

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons described below.

Do you meet the requirements under Section 501(q) of the Code? No, for the reasons described below.

Facts

You were incorporated on B as a non-profit under C law. Your Articles of Incorporation ("Articles") state, in Article III, that:

"The purpose for which the corporation is organized is: to assist individuals and families with financial problems by providing credit counseling services and other services including but not limited to, housing and home mortgage counseling, advice on payment of debts, assistance in negotiating with lenders, and assistance with setting up debt repayment plans and mortgage workout or restructuring plans and agreements."

Your Bylaws state in Article II that your specific purposes are:

The following are the purposes for which this organization has been organized: to assist individuals and families with financial problems by providing credit counseling services and other services including, but not limited to, housing and home mortgage counseling, advice on payment of debts, assistance in negotiating with lenders, and assistance with setting up debt repayment plans and mortgage workout or restructuring plans and agreements."

Your Form 1023 ("application") indicates that you offer financial education to your clients, tailored to meet their specific needs, which is offered through both housing and credit counseling services. In addition, you work with lenders and homeowners in crisis to secure more affordable terms enabling families to remain in their homes. Based upon a detailed cost price analysis your fees are lower than the current market rates and are not based in whole or in part on a percent of the client's debt. Individuals that need counseling services will not be turned away due to an inability to pay and contributions will not be solicited during the counseling process.

You have five directors, of which two are positioned officers. Those two officer/directors, D and E, are married; and another director, F, is D's mother. D and E are also listed as

your initial members in your Bylaws, and per your Bylaws, existing members can only vote in new ones. D and E will be compensated for their services. D, your President and Treasurer, will provide counseling and education services to clients including negotiating mortgage modifications. He has been assisting financially distressed families and individuals for over eight years. E, your Vice President and Secretary, also has over eight years of similar experience and will perform accounting, payroll, marketing and IT services as well as managing and supervising employees. You have not had any board meetings to date; the day-to-day operations are carried out by D and E.

D and E own and operate G, a for-profit company that was formed in 2002. G has been in the business of providing housing counseling, foreclosure mitigation and money management for eight years, servicing over 300 clients on a monthly basis. The homeowners referenced in your brochure were actually assisted by G, not by you. You intend on closing down the operations of G, no later than the end of 2010. You expect to service the same number of clients, and offer the same services as G, once you take over G's operations and client base. G is no longer accepting new clients; all new clients are being accepted through you. You also share a facility with G paying 5% of the monthly rent.

You stated that your members (employees) have been helping homeowners for almost eight years. "It is the same people, only a different organization name for the purpose of establishing tax exempt status, to better position the organizations ability to provide the services the members deliver." You perform regular follow-ups with your clients and the lender/servicer through e-mail, fax and telephone. Through G you have provided up to six clients a year services free of charge due to the inability to pay. You track your success rate of mortgage loan negotiations and do not close a file until after your client has agreed to the new terms of the loan and are in receipt of the modified agreement. All clients have the option to contact you up to 90 days after file completion.

Your submitted budgets include revenue from gifts, grants and contributions as well as related activity income. Approximately % of your revenue is expected to be derived from fees for services provided to clients. Approximately % of your expected expenses are devoted towards compensation of officers/directors. Discretionary bonuses may be offered to employees. Currently, for each successful outcome, an employee receives n dollars as a bonus. Finally, you submitted a Conflict of Interest policy; however, the policy shows no evidence of being adopted.

The primary service you provide is loss mitigation with respect to residential foreclosure. You do offer basic credit counseling, however, if a client needs credit counseling outside your expertise you refer them to local counseling agencies. You plan to offer debt management plans (DMP) and down payment assistance (DPA) in the future based

upon grant funding as well as establishing a credit counseling/debt management department. Funding for programs will be pursued after receiving your section 501(c)(3) approval. You are considering small group sessions as well as one-on-one training on the basics of budgeting

Your intake process for credit counseling begins with an initial interview by a staff member to determine eligibility for assistance. Information collected during the interview includes general client information, financial information and a hardship explanation. A discussion includes whether or not the client can benefit from your services or services available through outside agencies as well as a detailed review of monthly expenses and income, including better budgeting habits. A written budget analysis is then provided to clients. If an individual does not sign up for your services you do not provide any materials. You have not conducted any workshops, classes or seminars on financial planning, budgeting, credit/debt relief or other educational programs offered to the general public. You generally spend one hour with individuals during the initial inquiry and 45 minutes during subsequent calls. You estimate spending at least \$4,000.00 on direct mail and at least \$2,000.00 on internet advertising per month. You submitted samples of your advertising materials.

Your initial counseling session for mortgage mitigation is a one-on-one interview, usually conducted over the phone. If the individual is deemed qualified, you request an enrollment contract be signed and returned within three days. The initial presentation includes a discussion of the hardship that caused the mortgage delinquency as well as available options such as loan modifications, partial claims, special forbearance plans, repayment plans, principal reductions, deed in lieu of foreclosure or a short sale. You consider various criteria when determining which services your clients qualify for including: total numbers of payments delinquent, monthly budget surplus/deficit, current interest rate, type of loan, previous workout options that were offered, homeowners insurance and property tax information, employment status, and liens against the property. The initial inquiry usually takes 45 minutes to 1 hour and subsequent follow-ups take 10-15 minutes per phone call for file processing and document preparation. You recommend that your clients participate in ongoing educational programs that may be available in their area, however, you do not provide the educational programs. Instead, you will assist a client in researching programs for debt consolidation, credit counseling and/or HUD in their area.

Your review process for a solution is generally 90-120 days. On average, you speak to clients once a week to discuss any changes in their finances or changes to their monthly budget. In addition, you are in contact with lenders regarding the modification. You are considering providing a financial success tool kit to new clients to reinforce the basic elements of budgeting. Each client receives written educational materials that

include the foreclosure laws for their state as well as an action plan that includes a crisis budget.

You purchase leads on an as-needed basis from a subcontracted individual, however, you do not have a formal contract to purchase the leads. You also receive mortgage default referrals through your website and from previous clients, attorneys, realtors and mortgage brokers. You also provide referrals to attorneys and realtors for clients needing legal advice or seeking to make a short sale of the property. You do not pay or receive referral fees, other than paying a \$.30 per lead fee to the subcontractor. You will seek funding from the National Foreclosure Mitigation Counseling program administered by NeighborWorks. You applied to HUD for funding, however, you have retracted your application due to the fact that you do not want to limit yourself to your county only, instead planning to provide services nationwide.

You charge fees for your services. You charge an enrollment fee of p dollars and a monthly fee of q dollars (not to exceed r dollars) regardless of the duration of time for the final product of service. The fee is refundable if the client terminates the contract within three business days, after that the client must show just cause for any refund request. If a workable solution to avoid foreclosure is not obtained, the client is entitled to a full refund less the p dollars enrollment fee. You submitted a copy of your fee waiver policy which states that your fees are automatically waived for individuals at % of the federal poverty level. Fees may also be waived on a case-by-case basis for those individuals between %- % of the federal poverty level. Clients are provided a copy of the policy prior to enrollment. You submitted copies of your enrollment agreement and your fee schedule. The fee is broken down into four monthly payments of q dollars, a fifth month payment of s dollars as well as the p dollars enrollment fee. Your fee schedule includes the following statement:

"Pending approval, of tax exempt status, all contribution amounts are tax deductible.."

Your counseling agreement states that a certificate of contribution for tax deduction will be provided to the client. Your clients are being advised that their fees are considered contributions for tax deductibility purposes. Contributions will not be required for clients eligible for state or federal programs such as K. You will receive compensation for these clients through the federal or state program. You have found that % of the time the client cannot afford a small contribution the homeowner does not meet the lender's criteria for enrollment as a "qualified candidate." You provide the HUD national hotline number for the homeowners not considered qualified candidates.

Assistance with fees or down payments required for loan workouts may be provided in the future. If awarded a grant/contract you will determine on a case-by-case basis which clients qualify for assistance. In addition, assistance with delinquent personal loans

and/or unsecured debt may also be provided to clients. In most cases, home equity loans can be negotiated through traditional modification methods. You negotiate to have the delinquency added to the unpaid balance and lower the rate to a fixed term. Currently, clients are referred to local debt settlement agencies but you plan to integrate this service once you obtain funding from grants and contract awards.

You submitted a copy of your lease agreement. The lessor is H, a for profit entity owned by E. E signed the lease as lessor and D signed the lease as lessee. Recently you moved to a new facility that is being leased from an unrelated third party. You also submitted a copy of an employment contract for J, which includes services to be provided to you and to G. The employment contract also provides for payment of a 15% commission on sales. In addition, you submitted copies of your website pages and a brochure. The brochure includes the following statements:

“In t, (you) successfully negotiated m work-out solutions for homeowners with delinquent mortgages.”

“(You) parent company – G”

Your website includes your phone number, which is identical to the number used by G. Also depicted on your website is L’s logo and a link to L’s website. L’s website states that they are your “partner.” You stated that you do not have a formal written agreement with L, they only serve as a source of referrals of homeowners. Referrals may arise in circumstances where the homeowner is considering a short sale. If the homeowner decides not to use your services the short sale will proceed through L. You do not pay or receive any fees through your contact with L. You receive a fee from homeowners that you assist in getting approval for and processing the short sale.

You plan to establish a credit counseling/debt management department in the future. Funding for the program will be pursued after receiving your section 501(c)(3) approval. You are considering small group sessions as well as one-on-one training on the basics of budgeting. You do not anticipate beginning these programs for a period of 6-9 months after approval of tax-exempt status.

Law

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 501(q) of the Code provides that organizations which provide “credit counseling

services" as a substantial purpose shall not be exempt from taxation under section 501(a) unless they are described in sections 501(c)(3) or 501(c)(4) and they are organized and operated in accordance with the following requirements:

- (A) The organization--
 - (i) provides credit counseling services tailored to the specific needs and circumstances of consumers,
 - (ii) makes no loans to debtors (other than loans with no fees or interest) and does not negotiate the making of loans on behalf of debtors,
 - (iii) provides services for the purpose of improving a consumer's credit record, credit history, or credit rating only to the extent that such services are incidental to providing credit counseling services, and
 - (iv) does not charge any separately stated fee for services for the purpose of improving any consumer's credit record, credit history, or credit rating.
- (B) The organization does not refuse to provide credit counseling services to a consumer due to the inability of the consumer to pay, the ineligibility of the consumer for debt management plan enrollment, or the unwillingness of the consumer to enroll in a debt management plan.
- (C) The organization establishes and implements a fee policy which--
 - (i) requires that any fees charged to a consumer for services are reasonable,
 - (ii) allows for the waiver of fees if the consumer is unable to pay, and
 - (iii) except to the extent allowed by State law, prohibits charging any fee based in whole or in part on a percentage of the consumer's debt, the consumer's payments to be made pursuant to a debt management plan, or the projected or actual savings to the consumer resulting from enrolling in a debt management plan.
- (D) At all times the organization has a board of directors or other governing body--

- (i) which is controlled by persons who represent the broad interests of the public, such as public officials acting in their capacities as such, persons having special knowledge or expertise in credit or financial education, and community leaders,
 - (ii) not more than 20 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the repayment of consumer debt to creditors other than the credit counseling organization or its affiliates), and
 - (iii) not more than 49 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees).
- (F) The organization receives no amount for providing referrals to others for debt management plan services, and pays no amount to others for obtaining referrals of consumers.

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

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

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

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

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization's assets must be dedicated to an exempt purpose, either by an express provision in its governing instrument or by operation of law.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

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

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

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

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

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

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, holding the funds in a trust account and disbursing the funds on a partial payment basis to the

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

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

The Service compared this holding with the holding of Rev. Rul. 65-299, which holds that a nonprofit organization formed to advise, counsel, and assist individuals in solving their financial difficulties by budgeting their income and expenses and effecting an orderly program for the payment of their obligations qualifies for exemption from federal income tax under section 501(c)(4) of the Code (rather than under section 501(c)(3)).

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. 178 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (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. Proc. 86-43, 1986-2 C.B. 729, describes the methodology test the Internal Revenue Service uses to determine when the advocacy of a particular viewpoint or position is educational under sections 501(c)(3) of the Code and 1.501(c)(3)-1(d)(3) of the regulations. The revenue procedure states that the focus of section 1.501(c)(3)-1(d)(3) is on the method the organization uses to communicate to others, not the content of its communication. The method of communication is not educational "if it fails to provide a development from the relevant facts that would materially aid a listener or reader in a learning process." One factor indicating the method is not educational is as follows: "[t]he approach used in the organization's presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter." The

remaining factors relate specifically to advocacy organizations and the "full and fair exposition" part of the regulation.

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

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services did not satisfy the operational test under section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the 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, 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 is an umbrella organization made up of numerous credit counseling service agencies. These agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they did provide such services free of charge. As an adjunct to the counseling function, they offered a 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. 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. Tax Case. 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 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. The founder and his spouse were the only member's of the organization's board of directors. The organization did not have any meaningful educational program or materials for providing 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 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 private interests.

Finally, the Tax Court held that the facts in Credit Counseling Services of Alabama v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978) "stand in stark contrast" because "the

sale of DMPs is the primary reason for [Solution Plus's] existence, and its charitable and educational purposes are, at best, minimal."

Application of Law

Section 501(c)(3) of the Code sets forth two main tests for an organization to be recognized as exempt. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). Section 1.501(c)(3)-1(a)(1) of the regulations. Based on the information you provided in your application and supporting documentation, we conclude that you fail both tests.

Organizational Test

To satisfy the organizational test, an organization must have a valid purpose clause and a valid dissolution clause. Section 1.501(c)(3)-1(b)(1)(i) and 1.501(c)(3)-1(b)(4) of the regulations. A valid purpose clause limits the organization's purposes to one or more exempt purposes and does not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Your Articles do not limit your purposes to one or more exempt purposes. Specifically, providing assistance to individuals and families with financial problems by providing credit counseling and other services, including, but not limited to, housing and home mortgage counseling, advice on payment of debts, assistance in negotiating with lenders, and assistance with setting up debt repayment plans and mortgage workout or restructuring plans and agreements, is not an exempt purpose. Therefore, you do not have a valid purpose clause. Accordingly, you are not organized for exempt purposes.

Operational Test

To satisfy the operational test, an organization must establish that it is operated exclusively for one or more exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations. The actual purposes of an organization may be discerned by the activities it conducts. B.S.W. Group, 70 T.C. 352 (1978). You failed to establish that you are operated exclusively for one or more exempt purposes.

Your Activities Are Not Educational

You are distinguishable from the organizations in Consumer Credit Counseling Service of Alabama, *supra*, and Rev. Rul. 69-441 by the methodology you use to conduct your counseling activities. You stated that both your credit counseling and mortgage mitigation programs entail an initial interview, lasting approximately one hour, to

determine eligibility that includes a discussion of your services and a review of the client's financial situation. Clients that do not sign up for any of your services do not receive any educational materials or budgeting information. However, unlike the organizations in Consumer Credit Counseling Service of Alabama, *supra*, and Rev. Rul. 69-441, *supra*, you do not offer counseling sessions that are structured primarily to improve your clients' understanding of their financial problems or their skills in solving them. You provided no evidence that your employees do anything other than sit down with your clients to fill out the information that is needed to submit a statement of their financial condition to the lender. Two of your directors have previously owned and operated a for-profit credit counseling and mortgage mitigation corporation, G. G conducted the same activities and uses the same facility and phone number. Loss mitigation is your primary service, after the initial interview your follow-ups are with the lender and the client regarding negotiating the modification. Finally, you stated that you do not provide ongoing educational programs to your clients. Communicating with a homeowner to fill out a financial worksheet and an intake sheet is not an educational activity because the communication does not provide a development from the relevant facts that would materially aid a listener or reader in a learning process. Rev. Proc. 86-43, *supra*. Therefore, you failed to establish that your interactions with clients provide instruction or training "useful to the individual and beneficial to the community" within the meaning of section 1.501(c)(3)-1(d)(3)(i) of the regulations.

You do not operate a substantive on-going educational program. You have not conducted any seminars or workshops to date, nor do you require your mortgage mitigation clients to participate in an ongoing educational program. You may utilize alternative educational methods in the future, however, you are considering small group sessions as well as one-on-one training in the basics of budgeting. You have not submitted any educational materials or other evidence of an educational program. You do not dedicate any revenue to activities involving educational programs. You do not allocate any expenses to training employees. Like the organization in Solution Plus, *supra*, you did not provide evidence that you help clients develop an understanding of the cause of their financial problems or a plan to address their financial problems. You provided no evidence that you intend to establish long-term counseling relationships with your clients.

Your Activities Are Not Charitable

All of your time and resources are devoted to providing mortgage modification services to individuals who are not part of a charitable class. Helping homeowners at risk of foreclosure negotiate a modification to the terms of their mortgage 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.

The mortgage mitigation services you provide to individuals do not further charitable purposes. You represent that everyone is eligible for your services regardless of income. Therefore, your services are not directed exclusively to low-income individuals. Accordingly, you are unlike the organizations described in Consumer Credit Counseling Service of Alabama, *supra* and Rev. Rul. 69-441, *supra*, which aided low-income individuals and families who have financial problems, thereby relieving the poor and distressed. Thus, you failed to establish that your activities are charitable within the meaning of section 501(c)(3) of the Code.

You Have a Substantial Nonexempt Commercial Purpose

The courts have developed guidelines intended to help discern whether an organization has a substantial nonexempt commercial purpose. See e.g., B.S.W. Group, *supra*; Easter House, *supra*; Airlie, *supra*; Living Faith, *supra*. Generally, the factors proffered by courts focus on the nature of the activities and how an organization conducts its business.

You charge fees for your services, including an enrollment fee of p dollars and a monthly fee of q dollars, not to exceed r dollars. The fee is refundable if the client terminates the contract within three business days; after that, the client must show just cause for any refund request. In the event fees are paid you are advising individuals these qualify as deductible contributions. Your operational focus is on generating fees from your consulting activities through the receipt of grants and donations rather than fees charged to clients. You did submit a fee waiver policy for individuals at 100% of the federal poverty level, they may also be waived for those clients between 101-250% of the federal poverty level on a case-by-case basis. Although you do have a fee waiver policy, you have found that 100% of the time that a client cannot afford a fee the homeowner does not meet the lender's criteria as a qualified candidate. Similar to the organization in Solution Plus, *supra*, your efforts are focused on informing potential clients about the mortgage mitigation service available and signing them up for your services. In fact, your client agreement states that the counselor is only providing assistance with negotiating a loan modification. Like the organizations described in Solution Plus, *supra*, Better Business Bureau, *supra*, and Easter House, *supra*, your activities have an underlying commercial motive that distinguishes your activities from those carried out by a section 501(c)(3) organization. Thus, your activities are not educational within the meaning of section 501(c)(3).

A substantial part of your activities consists of providing research services to E and other investors for a fee. Researching borrowers and property in residential mortgage backed securities portfolios is not an exempt purpose, as recognized by statute or by case law, but rather a substantial nonexempt commercial purpose.

Your finance structure further demonstrates that you operate for a substantial nonexempt commercial purpose. You expect approximately 65% of your revenue to be derived from fees for services. In addition, 67% of your expected expenses are devoted to compensation of officers/directors. There is no evidence that you have received contributions or gifts from disinterested members of the public. Accordingly, you are like the organization described in B.S. W. Group, supra as its financing did not resemble that of the 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 for services, and those fees were set high enough to recoup all projected costs and to produce a profit. Your operations are financed entirely by revenue earned from selling services to E and other investment firms and donations from E, a related entity. Receiving support primarily from consulting fees is indicative of a nonexempt purpose. Easter House, supra.

Like the organizations in Easter House, supra, Airlie, supra, and Living Faith, supra, you are in direct competition with commercial businesses because you conduct consulting activities, generally for a profit. In fact, you are a successor to a for-profit organization, G, that conducts the same services as you for a fee. You utilize the same phone number as G, and two of your five directors are the owners of the predecessor. In addition, one of your employees is also an employee of G. G is ceasing operations as you begin operations. You conduct your consulting activities in the same manner as commercial enterprises. For example, you use similar pricing, financial structure, and relationships with other for-profit companies. Accordingly, your activities evidence a substantial nonexempt commercial purpose. The activities you identify as "charitable" are merely incidental to your business of providing consulting services for a fee. Your operational focus is on generating consulting fees from your consulting activities. Like the organizations described in Better Business Bureau, supra, and Easter House, supra, your activities have an underlying commercial motive that distinguishes your activities from those carried out by a charitable organization. Thus, more than an insubstantial part of your activities are in furtherance of a nonexempt purpose, in contravention of section 1.501(c)(3)-1(c)(1) of the regulations. Therefore, you are not operated for an exempt purpose.

Inurement

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

You do not have adequate safeguards to protect assets since three related members of your Board of Directors control you. Your conflict of interest policy (COI) was not executed by your governing body. Regardless, under the terms of your purported COI,

three of your directors are prevented from determining whether a conflict exists with regards to transactions or arrangements regarding your lease agreement with H and compensation of C and D. Thus, you failed to demonstrate that insiders will not benefit from your operations now or in the future.

Private Benefit

An organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Section 1.501(c)(3)-1(d)(1)(ii) of the regulations. The mortgage mitigation services that you provide to homeowners do not serve a public interest. Nor are the beneficiaries of your services poor or distressed individuals. Your services benefit the private interests of individual homeowners by relieving them of the burden of negotiating a modification with their lender. In addition, you make referrals for short sales to L, a for-profit organization. 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).

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. Thus, even if you had established that you engage in such activities as a substantial purpose, to be exempt from taxation you must, in addition to complying with the requirements of section 501(c)(3), comply with the provisions of section 501(q).

You do not comply with certain provisions of section 501(q) of the Code. An exempt credit counseling organization must establish and implement a fee policy which requires that any fees charged to a consumer for services are reasonable and allows for the waiver of fees if the consumer is unable to pay. Section 501(q)(1)(C). You charge your clients fees for your services, however, you failed to establish that you have a fee waiver policy for those clients that cannot afford to pay the fee. While you did submit a fee waiver policy you also stated that you have found that individuals who cannot afford to pay a fee are not considered qualified candidates by lenders and therefore would not be eligible for your services.

You do not provide credit counseling services tailored to the specific needs and circumstances of consumers. Section 501(q)(A)(i). You do not provide educational information to the public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of credit. Nor do you assist individuals and families with financial problems by providing them with counseling. Section 501(q)(4)(A). You have provided no educational seminars or workshops to the general public and no

educational materials distributed to your clients. You spend most of your time negotiating with lenders and only the initial session on your meeting with clients. Therefore, you do not meet the requirements under section 501(q).

Finally, you indicated that D and E are officers and directors, and both receive compensation from you as employees. Therefore, more than 20% of the members of your Board of Directors are also compensated as employees. Section 501(q)(D)(ii).

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

Conclusion

Based on the facts and information provided, you are not organized or operated exclusively for exempt purposes. You are not organized exclusively for exempt purposes as required by section 1.501(c)(3)-1(b)(1)(i) of the regulations because your Articles of Incorporation do not restrict you to section 501(c)(3) purposes. You are not operated exclusively for an exempt purpose as required by sections 1.501(c)(3)-1(a)(1) and 1.501(c)(3)-1(c)(1) of the regulations because you are not educating your clients nor do you provide your services to poor or distressed individuals. You are organized and operated for commercial purposes in contravention of section 1.501(c)(3)-1(c)(1) of the regulations because you provide mortgage modification services for substantial fees. Any public purposes for which you may operate are only incidental to this primary nonexempt purpose. You have not demonstrated that you do not allow your net earnings to inure to private individuals as required by section 1.501(c)(3)-1(b)(2) of the regulations. You do not serve a public rather than a private interest as required by section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Therefore, you are not described in section 501(c)(3).

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

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892. These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal 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 the applicable 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 fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure, Publication 892