

Internal Revenue Service
Appeals Office

Department of the Treasury

Taxpayer Identification Number:

Release Number: 201219040

Release Date: 5/11/2012

Date: February 15, 2012

Person to Contact:

Tel:

Fax:

Tax Period(s) Ended:

UIL: 501 .03-00

Certified Mail

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective XXXXX.

The revocation of your exempt status was made for the following reason(s):

You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3) and Treasury Regulations section 1.501(c)(3)-1(d). You did not engage primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3). You are operated for a substantial nonexempt purpose, which is not an exempt purpose.

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

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of revocation, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want

Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

**XXXXX
Appeals Team Manager**

Enclosure: Publication 892



DEPARTMENT OF THE TREASURY
Internal Revenue Service

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

June 9, 2008

ORG
ADDRESS

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

Letter 3618 (04-2002)
Catalog Number 34809F

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez Director, EO
Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Letter 3618 (04-2002)
Catalog Number 34809F

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer XXXXX		Year/Period Ended 08/31/XXXX 08/31/XXXX 08/31/XXXX

ISSUES

- 1) Whether XXXXX operated exclusively for exempt purposes within Internal Revenue Code section 501(c)(3)?
- 2) Whether XXXXX is engaged primarily in activities that accomplish an exempt purpose?
- 3) Whether more than an insubstantial part of XXXXX activities are in furtherance of a non-exempt purpose?

FACTS

Background

XXXXX(hereinafter, "XXX") was incorporated under the laws of the State of XXXXX as a non-stock, nonprofit corporation on September 11, XXXX. In a determination letter dated July 21, XXX, XXX was determined to be exempt from federal income tax as an organization described in IRC Section 501(c)(3). During the years under examination, XXX was located at XXXXX, XXXXX, XXXXX, XXXXX XXXXX. XXX recently relocated and the current address is XXXXX, XXXXX, XX XXXXX.

XXX was founded by XXXXX, who was also the founder and President of XXXXX, Inc. a for-profit debt management company from whom XXXXX purchased its clients accounts in XXXX. From XXXX to XXXX XXXXX provided the backroom services for XXX. During the years under examination, XXX conducted all of its backroom services in-house.

XXX filed its Articles of Incorporation on September 11, XXXX with the XXXXX Department of State, Division of Corporations. XXX's Board of Directors consisted of three individuals: XXXXX, XXXXX, and XXXXX. XXXXX served as President, Vice President, Treasurer and Secretary. XXXXX was also the Registered Agent of XXX. XXX submitted its application for exemption (Form 1023) on September 16, XXXX.

In its Articles of Incorporation, XXX described its purpose as follows:

XXXXX is organized exclusively for religious, charitable, scientific, literary, and educational purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1986 or the corresponding provision of any future United States Internal Revenue Law.

In its original application for exemption, XXX described its planned activities as follows:

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- A. Organization formed to educate debtors, consumers and general public with respect to financial obligations and potential problems which may arise from use of credit card financing and other debt.
- 1) Primary activity shall consist of debt assistance service which is designed to alleviate onerous interest rates and/or financing costs charged by some creditors to consumers. This activity will allow the organization to assist such consumers with their financial obligations. At the same time these consumers engage the above described services, educational information will be supplied so that the consumer may be apprised of how to avoid specific financial pitfalls.
 - 2) Secondary activity shall consist of multimedia campaign designed to increase general public awareness.
- B. Activities will be initiated on or around December 1, XXXX.
- C. Activity will be conducted at corporate offices, primarily by and through the corporate directors.

Regarding XXX's sources of financial support, Form 1023 stated the following:

The organization's primary source of financial support shall consist of contributions from business organizations which deal with consumers who engage the filing organization's services. The remaining source of financial support shall consist of private contributions.

Regarding fundraising, Form 1023 stated the following:

The organization shall solicit contributions from those same business organizations which deal with consumers who engage the organization's services. Additionally, through limited direct contacts, the organization shall solicit various business organizations for financial assistance.

Activity Description

The primary activity engaged in by XXX during the years ended August 31, XXXX, August 31, XXXX and August 31, XXXX, is the telephone solicitation of clients to enroll in debt management plans (hereinafter, "DMP"). Potential clients are individuals with unsecured debt. A DMP is a plan whereby a client makes monthly payments to XXX to satisfy his/her unsecured debts generally over a 3-5 year period. Most of the debts handled in a DMP are credit card debts, but other unsecured debts may also be included. Upon agreeing to a DMP, the client makes payments to XXX which are then distributed to the client's creditors, minus XXX's monthly service fee. In addition to the monthly service fee, XXX also charged the client an initial enrollment fee. This enrollment fee consisted of the client's entire first monthly payment. The Service Agreement states the following regarding said fee:

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Payment. Upon presenting the initial payment schedule under the program to Client, XXX shall have earned a fee from Client in an amount equal to the first month's payment under the program. Client's first month payment shall satisfy the fee. Unless otherwise specified herein, all subsequent payments shall be distributed to Client's creditors.

It does not matter whether the monthly payment is \$100 or \$1,000, XXX keeps the entire first monthly payment. Regarding the monthly service fee, XXX's Service Agreement indicates that the fee covered the cost of telephone calls, photocopies, facsimile charges, bank fees, postage, data processing, and account servicing. This service fee varied depending upon the amount of debt and number of creditors. This monthly service fee ranged from a minimum of \$29 per month up to one percent of the Client's annualized monthly payments. On March 24, XXXX, the United States Senate Permanent Sub-Committee on Investigations issued a report on the credit counseling industry, "Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling." That report found that "the average initial fee to set up a DMP with an NFCC agency (National Foundation for Credit Counseling) in 2002 was \$23.09 and the average monthly maintenance fee was \$14.00."

This Service Agreement also includes a Program Completion Award certificate. Details concerning the award as spelled out by the agreement are as follows:

This certificate entitles the program participant to a Program Completion Award equal to their first month's payment less any funds advanced by XXXXX on behalf of the Client upon the completion of their Debt Consolidation Program. Completion of the program shall be defined as payment in full to all original creditors in accordance with the Program.

For the years under examination, XXX returned enrollment fees to their clients in the following amounts: \$ (XXXX), (XXXX) and \$ (XXXX). On average, XXX returned to the client between 15% - 18% of the amount of the enrollment fees it actually charged. XXX indicated in a letter dated 12/11/XXXX, that they have discontinued the practice withholding the first month's payment as an enrollment fee. This practice was discontinued after the commencement of the examination. XXX now charges an enrollment fee of \$50 to \$65. XXX also started a hardship program whereby no enrollment fee is charged. XXX also indicated in its letter dated 12/11/XXXX that they waived enrollment fees for 95 clients since 7/1/XXXX, after the examination began. Prior to 7/1/XXXX, XXX could not verify any instances whereby they waived the enrollment fee.

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XXX has also given “goodwill refunds” to clients that did not complete the DMP program due to circumstances which caused them to decide to drop out of the DMP program and file for bankruptcy. These refunds amounted to \$254.

XXX operated a call center, where all of its activities were conducted in relation to soliciting and enrolling clients in DMP’s. XXX purchased leads and its employees called individuals in hopes of obtaining their agreement to enter into a DMP. This was the only purpose for purchasing leads. Through search engine placement, potential clients who were seeking additional information on consolidating their debts, were routed to XXX’s website. There, they could submit an on-line debt consolidation application which XXX used to initiate contact with the potential client. Contacts with clients were by phone or fax. A minimal number of contacts, if any, were made through ‘walk-ins.’

XXX operated as follows: Contact with a potential client would be made by telephone. During the phone call, the employee would attempt to enroll the potential client in a DMP. The employee would ask the person for information regarding income and expenses, and their current unsecured debts. The employee would then prepare a “Proposal-Financial Addendum” which contained name, date, client ID#, on which the employee would list all income sources and household expenses. This form is used to determine whether or not the client has sufficient disposable income to enroll in the DMP. If the potential client’s expenses exceed his/her income, the client is not eligible for a DMP. The individual is informed of this and XXX offers no other services to assist the individual with their debt difficulties. If the client has disposable income, a list of all debts to be covered by the plan, and a “Quote Worksheet.” is prepared which lists all eligible creditors that would be included in the DMP and the amounts of the current payments as compared to the payment the client would be required to make if they enroll in the DMP program. The Worksheet lists the total owed to creditors, amount of monthly payments clients currently makes to creditors, proposed monthly payment, monthly service fee to be made, with the total number of monthly payments to be made. Based upon a review of the “Proposal-Financial Addendum” and “Quote Worksheet”, it does not appear that the amount of disposable income in the “Proposal-Financial Addendum” necessarily bore any relationship to the monthly payment required by the DMP. The primary intent of the DMP is to consolidate all unsecured debt, and possibly lower interest rates and monthly payments.

Employee Training:

XXX employed approximately 16 people who purportedly operated as “counselors.” (hereinafter referred to as “employees”).

XXX provided training material which XXX’s employees were trained to promote DMP’s. XXX’s training manual contains instructions for employees on all aspects of arranging, explaining, and maintaining DMP’s. Although the manual does give definitions of other options

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that clients may have, (i.e., bankruptcy, debt settlement, consolidation loans), XXX offers none of these options nor do they make referrals to any other agencies who might assist with other options. The instruction manual is geared to enrolling individuals in DMP's.

Employees were given a script to use in promoting the DMP. The phone script contained no educational information; it was aimed directly at getting enough information to make a determination whether the potential client will qualify for a DMP. The phone script is designed to be used by the employee to first determine the type of debt the potential client has. If the client has only secured debt, which does not qualify to be included in a DMP, the script offers no other options that the employee must offer the client. If the potential client has unsecured debt, the employee is prompted to gather information regarding their monthly income and expenses. This information is then used to determine only whether the client qualifies for the DMP. Once the employee determines that they do qualify, they continue. If the potential client is behind on their unsecured debt, the employees are instructed to explain how enrolling in a DMP can help them to stop late fees, reduce interest and to re-age an account. If the client is current, the employee is prompted to explain that by consolidating, they can lower interest so the debt can be paid off sooner. If the client agrees to enroll in a DMP, the employee continues to gather all necessary information to establish an account. Employees are instructed to advise clients that the first monthly payment will be kept by XXX and will not be disbursed to their creditors. They are also instructed to advise clients that once they complete the DMP, XXX will return the payment. Clients are instructed to fax or email the service agreement once they decide to enroll in a DMP. If the potential client does not qualify for the DMP, the script contains no other instructions for assisting the client in resolving their debt problems. The script is designed to promote only the DMP to the potential client.

XXX provided a copy of the study manual used by employees attempting to become Certified Credit Counselors. The study guide covers topics that, if utilized, would enable the credit counselor to assist consumers in assessing, understanding and dealing with their debt. However, employees were not observed utilizing information in the study guide during telephone calls. The main objective of the employee, as observed during the calls, is to determine whether the potential client will qualify for the DMP and to assist them in enrolling. If the potential client does not qualify for the DMP, there is no additional assistance provided by XXX.

Employee Contacts with Potential Clients:

In a typical call to a potential client, the employees introduce themselves as employees of XXX, and advise that they are calling in response to their on-line debt consolidation application. Normally, if the potential client did not answer and the employee left a message, the message advised that the employee would like to provide a quote and discuss the potential clients options regarding their debt. The employee would advise the potential client to call back and refer to their individual client ID number. If the potential client answered, the employee generally

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identified themselves and XXX and began by determining whether potential client has unsecured debt. Once it is determined that potential client has unsecured debt, employee commences asking questions to obtain amounts of potential client's income and expenses (rent, utilities, telephone, food, car expenses, medical expenses, Federal/State taxes, student, loans, etc). Employees write down this information on the Proposal-Financial Addendum. After this information is gathered, the employee determines, based on the amount of disposable income, whether the potential client qualifies for a DMP. If so, the employee explains how XXX can get lower interest rates, consolidate all accounts that the potential clients wants included and how client only has to make one payment to XXX, who will distribute amount less monthly service fee to creditors. Employees usually explain to potential clients how long it will take them to pay debt under circumstances and will compare this to how long it will take to pay of the debt if the enroll in the DMP. Employees explain how creditors have certain conditions that they set for persons who want to pay off their debts through enrolling in the program and that they are able to get interest rates reduced in most cases, as well as get penalties removed and accounts re-aged. They further advise that the program will pay the potential client's debts off faster and save thousands in interest. Employees refer to their Creditor Guidelines from which they determine the minimum payment each creditor will accept, amount of interest creditor will reduce its interest rate to, whether the creditor will waive its fees and whether creditor will re-age the potential clients account. Employee uses these Creditor Guidelines to arrive at a proposed payment amount. If the client agrees to enroll in a DMP, the client is generally sent the Service Agreement with instructions to sign the agreement and fax a copy to XXX. Clients are advised to initial each page of the agreement and to return the entire agreement. In a number of cases, the client expressed a need to discuss the proposal with a spouse or family member. The employee would then usually set up a time to contact the potential client to follow up. Once the client enrolled in a DMP, payment could be made in a variety of ways:

- Pay-by Phone (\$5.00 fee)
- Online payment-One time only (\$5.00 fee)
- Online Payment- Monthly payments - direct debit from bank account
- Money Gram (\$6.50 - \$6.95)
- Money Order or Cashiers Check
- Allotment (military clients) – direct debit from bank account

The Service Agreement entered into by the new client spells out the terms of the DMP. It explains the purpose of the agreement, spells out services that XXX will provide, cancellation rights, how payments will be applied, and client responsibilities. The agreement also contains clauses explaining that the client waives any rights to a trial by jury, agreement has no express or implied warranties, spells out limitation as it relates to XXX, and information explaining the amount of damages XXX may be liable for in connection with the agreement. It also provides an

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“Authorization” form which the client signs giving XXX authority to discuss and negotiate payment terms and conditions with the creditors. By signing the Authorization, the client acknowledges that they have read, understand, and accept the terms of the Service Agreement. At the end of the agreement, the Program Completion Award program is explained advising clients that they are entitled to their first month’s payment back, less any funds advanced to creditors by XXX.

Employee Bonus Structure:

XXX’ employees classified as “Credit Counselors” are paid a base salary plus bonuses. On March 2, XXXX XXX implemented a new bonus structure which was designed to reward employees based on a number of factors. The employee attempts to accumulate points based on a 100 point system, tabulated weekly. The bonus structure has 9 categories listed below:

1. Call Monitor Evaluation
2. Weekly Authorizations Received
3. Weekly Completed Files
4. Weekly Attendance
5. Phone Time
6. Daily Reports
7. Proper use of XXXX
8. Special Training
9. Professionalism

Points the employees earn are totaled at the end of the week and the amounts of bonuses ranged from \$0 per week (for 0-60 points) to \$1000 (100 points) per week (see Exhibit attached). Employee bonuses are directly tied to how many clients they signed up for the DMP as well as how timely and accurately they perform other duties such as completing DMP paperwork, being available to solicit clients for DMP’s, being on the phone a prescribed number of hours, completing follow up to clients, properly using the computer system (XXXXXX) to input client data, special training , and the employees professionalism when making phone contacts. Employees must sign the Credit Counselor Bonus Structure Agreement. Employees also earned additional bonuses with special promotions initiated by management

Advertising and Marketing:

XXX advertised its services on its website, www.XXXXX.org. XXX also utilized broadcast messaging as a means to generate interest in its services. XXX contracted with XXXXX to send phone messages to potential clients. A message would be delivered to potential client either on a live call or to the potential client’s answering machine. A potential client who answered would receive the following message:

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Hi this is _____ with XXXXX.

Are you like 80% of all Americans and have credit card debt over \$5,000?

If so, our certified credit counselors would like to take this opportunity to give you a free debt consultation. We can design a low cost program that may reduce your monthly payments and interest by up to 50% enabling you to save thousands of dollars, and design a household budget that is workable for you. Press 1 to be connected with a counselor that can approve you for this exciting opportunity.

(Pause for a few seconds)

Or press 2 to be removed

XXX also utilized search engine placement whereby a link to their website will be strategically placed very high in the list of results the researcher receives when using key words to search for debt related issues using a search engine (i.e. Google). Once directed to XXX's website, a potential client can submit an online debt-consolidation application and an employee will call them back.

In addition, XXX purchased client leads from at least 4 different companies during the years under examination. One of the companies from which XXX purchased leads, XXXXX (hereinafter "XXX") was owned by the founder of XXX, XXXXX. Based on the "Sales Lead Insertion Order Agreement" XXX contracted with XXX to provide "qualified debt consolidation/credit counseling sales leads" for the sole use by XXX on a daily basis (Monday-Friday, excluding holidays). A qualified lead, as defined by the agreement, consists of the following:

- a. Name of prospective client
- b. Working phone number of prospective client
- c. Amount of prospective client's outstanding debt
- d. The state of residence of the prospective client
- e. The valid email address of prospective client

XXX paid \$25 per qualified lead to XXX. The amount paid to XXX for leads is comparable to what XXX paid to other lead generating companies it did business with.

Education and Outreach:

In addition to its DMP activities, XXX claims to have engaged in educational outreach during the years under examination. XXX, however, kept no records to verify its education outreach activities. In its Annual Report for the year ended 8/31/XXXX, XXX makes the following claims:

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We started the year offering Debt Alliances' three part workshop "Money, Debt, and Credit" at the local community center promoting the offering via posted flyers and PR media announcements, attendance was almost non-existent. Another approach was to offer the 10 part series sponsored and authored by FDIC titled "Money Smart" through the XXXXX. During the Fall/Winter session the course was administered to advanced ESOL (English Speakers of Other Languages) students and was very well received. Program administration then allowed us to offer the course to the general public and we were included in the spring session mailer and newspaper supplement the "XXXXX". However no prospective students enrolled.

XXX kept no contemporaneous records to substantiate the above activities. The "education" described is not ongoing and XXX apparently abandoned such methods due to little or no interest generated.

For tax year ended 8/31/XXXX, XXX described community outreach activities that it conducted in conjunction with an after school program for disadvantaged youth. The Annual Report only mentions 2 events conducted by XXX for this program. XXX conducted an educational conference in May XXXX for the annual "College Night" and in August, XXXX for "Back to School Day". Again, no contemporaneous records were kept to support XXX's outreach activities. The amount of time devoted to these "outreach/educational" activities was minimal compared to XXX's primary activity of soliciting potential DMP clients and processing DMP's.

For tax year ended 8/31/XXXX, XXX, in its Annual Report, makes claims that they provided education and community outreach. The outreach activity consists of one event in August, XXXX at disadvantaged youth after-school program. The report states the following:

In August of XXXX, XXX sent a crew of Certified Credit Counselors along with XXXXX Still to participate in "Back to School Day" at the XX center. We were able to meet one on one with the parents of the children attending. We provided a free copy of our financial literacy course "Your Money" to all who attended. We also provided the brochure "Understanding Budgeting and Debt management".

This outreach activity was a one time event held in the state of XXXXX, and there are no other community activities listed. XXX kept no contemporaneous records detailing

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number of participants, names and addresses of those attending or amount of materials distributed. Consumers in other states serviced by XXX were provided no community outreach activities. Any other education materials provided are through XXX's website which will generally only be visited by consumers interested in consolidating their debt.

XXX maintains that it is providing education to potential clients through its telephone contacts. XXX alleges that one of the ways it is providing education to potential clients is by completing and discussing a budget. Although XXX does ask potential clients for information regarding their income and expenses, this information is only used to determine whether or not the potential client will qualify for a DMP. The potential client is not educated on ways to create their own personal budget to live by, how to maintain a budget, how to track expenses, or how budgeting can help them to set and achieve their goals. The Proposal-Financial Addendum which the employee completes and records the potential client's income and expenses on is only used by XXX. It is, in fact, not a budget at all. Its only purpose is to list the potential client's income and expenses and compare the two to determine whether or not the potential client has enough disposable income to qualify for the DMP.

During the observation of telephone calls by the Agent, XXX employees were observed answering potential client's questions regarding issues such as FICO scores, bankruptcy or whether or not their enrollment in a DMP will negatively affect their credit report. If a potential client who was considering enrolling in a DMP had questions about how their enrollment might affect these areas, the employee always answered the question asked by the potential client and sometimes referred them to other websites such as myfico.com for further information. However, this information was dispensed and used only to help convince the potential client that the DMP was their best option. This information was only offered when the potential client asked or expressed concern about whether enrolling in the DMP would affect them negatively. Bottom line, the goal of all calls made by the employee is to determine whether the potential client qualifies for the DMP and then try to convince them to enroll. If the potential client did not qualify, XXX had no other services or programs that they could offer.

XXX also maintained that they provided free educational material to every potential client, whether they enrolled in a DMP or not. When clients submit an on-line application for debt-consolidation, an address is not required. If XXX never makes phone contact with the potential client, there is no way they can provide education material to them. The Agent listened to numerous telephone calls that XXX made to potential clients. In only one (1) call did a XXX employee offer to send educational materials to a potential client. XXX kept no records to verify the number, names and addresses of clients it sent educational materials to during the years under examination.

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XXX includes a self-study money management course on its website. Consumers are not required to provide personal information in order to access the course which includes chapters on Understanding Money, Understanding Debt, and Understanding Credit. XXX offers a "Certificate of Completion" to persons completing the course. XXX kept no contemporaneous records on how many people took and/or completed the course. XXX also did not require its client to take the course.

XXX's purpose is to first and foremost attempt to enroll potential clients in a DMP. Its "educational" activities are minimal, at best. If the potential client never asks the employee questions regarding credit reports and FICO scores, XXX employees never volunteered that information. Once the potential client either declined or was not qualified for a DMP, XXX had no more use for that potential client and maintained no further contact with them. No calls were observed where potential clients were referred to other agencies or organizations that could assist them with their particular credit difficulties. XXX made no referrals to other agencies that could assist consumers with their debt problems. Employees are only given a list of social service agencies and can only provide to consumers a telephone number, address or website.

Backroom Services

Prior to Fiscal Year Ending August 30, XXXX, XXX contracted with XXXXX (hereinafter "XXXX") and XXXXXnc. (hereinafter "XXX"), to provide backroom services for its active client accounts. On August 3, XXXX, XXX purchased the assets of both XXXX and XXX and brought all backroom services in-house. The sales contract includes the purchase of active clients as well as the rights, title and interest in the client contracts, software, furniture and equipment of XXXX for \$. From XXX, XXX purchased all of its computers, monitors, servers, printers and other related equipment for \$ For the years under examination, XXX performed all duties related to soliciting and enrolling clients in DMP's as well as all paperwork and processing. XXX receives and deposits all client DMP payments, deposits them into a bank account controlled by XXX, and disburses payments to the client's creditors.

In addition to distributing payments of creditors, XXX solicits "fair share" contributions from credit card companies. The term "fair share" refers to a payment made by the credit card companies who are receiving payments pursuant to a DMP. Typically, credit card companies pay a fair share, which is a stated percentage of debt, to credit counseling organizations that set up DMPs; the amount paid is determined by each creditor in advance. Credit card companies will

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only make “fair share” payments to organizations recognized as exempt under section 501(c)(3) of the Internal Revenue Code. “Fair Share” payments are paid directly to XXX by creditors.

Summary of Revenue and Expenses:

Information from Form 990 shows the following income and expenses for XXX during the tax years ending (TYE) August 31, XXXX, August 31, XXXX, and August 31, XXXX:

TYE	Revenue	Expenses	Profit
8/31/XXXX	\$	\$	\$
8/31/XXXX	\$	\$	\$
8/31/XXXX	\$	\$	\$

LAW

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

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

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

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

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Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3). In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an “underlying commercial motive” that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

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

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

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled

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

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

In the case of Solutions Plus, Inc. vs Commissioner of Internal Revenue (T. C. Memo 2008-21), on February 5, 2008, the tax court overwhelmingly supported the Internal Revenue Service in finding that the credit counseling organization was not a 501(c)(3) charitable or educational organization. The organization stated its intent to offer and service DMP’s on a national scale. The organizations intended goal was to solicit potential clients for DMP’s. There would be no other assistance provided to clients who did not qualify for DMP’s. The court failed to find a meaningful education program or educational materials that the organization might send to prospective clients. It found that the organization’s plans to provide seminars and workshops to high school students on sound financial management skills were an insignificant part of its overall activities. It held that the organization’s activities were primarily structured to market, determine eligibility for, and enroll individuals in DMP’s. The court concluded that the sale of DMP’s was the organizations primary reason for existence, and its charitable and educational purposes were, at best, minimal. It held that the organization did not qualify for tax-exempt status 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. 179 (free

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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.

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

The CROA defines a credit repair organization as:

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

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

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

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission. 16 C.F.R. § 310.4(b)(1)(iii)(B); 47 C.F.R. § 64.1200(c)(2). Section 501(c)(3) organizations are not subject to this rule against cold-calling. Because 501(c)(3) organizations are exempt from regulation under the CROA and the cold-calling restrictions, organizations that are involved in credit repair have added incentives to be recognized as section 501(c)(3) organizations even if they do not intend to operate primarily for exempt purposes.

GOVERNMENT’S POSITION

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In order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated to achieve a purpose that is described under that Code section. XXX operates a trade or business in a commercial manner designed to maximize profits rather than serve charitable purposes. Its activities further the private interests of clients who enroll in DMP's as well as their creditors. Persons who enroll in a DMP can get lower interest rates on their unsecured debts, whether or not they can afford to pay their debts or not. If a potential client is current on all unsecured debt and their financial circumstances indicate that they have enough disposable income to easily pay their debts, they can still enroll in a DMP. The DMP is not limited to low-income persons. Credit card companies and other creditors benefit because the clients debts are still paid, with interest (albeit at a lower interest rate). XXX's activities are almost exclusively dedicated to contacting potential clients who are likely to have a need to enroll in a DMP and assisting them in doing so. There are no other meaningful activities conducted. XXX's primary goal is to maximize the fees from these DMP's. XXX's services are marketed to persons who have been identified as having a need for debt consolidation through leads or by being directed to its website through internet research or by other marketing techniques. Alliances are built with the credit card companies and other creditors to assure future business for the mutual benefit all participants in the DMP transaction. Because XXX's primary activity is not conducted in a manner designed to further section 501(c)(3) purposes, XXX is not operated exclusively for exempt purposes within the meaning of section 501(c)(3). The purpose of XXX's activities differs substantially from those of the organizations in Rev. Rul. 65-299, Rev. Rul. 69-441, and Consumer Credit Counseling Service of Alabama, Inc. v. U.S.

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

XXX trained its employees to promote DMP's. The employees classified as "counselors" market and sell DMP's to any consumer. There is no substantiation that fees were waived for persons who are unable to afford the services of XXX. There is no actual counseling provided to consumers who contact or are contacted by XXX. Their bonus structure rewarded volume of enrollment of consumers in DMPs, and did not allow any meaningful credit counseling to take

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place. Almost every aspect of the bonus structure is tied to the DMP. Employees received bonus points for the number clients enrolled in a DMP, client DMP files completed, amount of time on phone soliciting potential clients for DMP's and the proper use of the computer application (XXXXX) which houses and maintains information for clients who enrolled in a DMP. The bonus structure reinforces this work environment by setting goals for employees to make, at a minimum, 400-500 calls per week in order to earn bonus points. No meaningful education or counseling could take place in such a time frame on a telephone call. Unlike the credit counseling organizations described in the Revenue Rulings referred to above, and in Consumer Credit Counseling Service of Alabama, Inc. v. U.S., XXX provides very little counseling or education to its clients.

Also, XXX's alleges in its annual reports that they provide education and community outreach to the public. XXX provided no contemporaneous records to substantiate such education/outreach activities. XXX also claimed that they provided free educational materials to every potential client, whether they enrolled in a DMP or not. XXX could not provide a list of the clients or potential clients they provided this information to and the Agent, after listening to numerous telephone calls made by the employees, only observed one(1) offer of free educational materials to be mailed to a consumer. XXX kept no records to verify the number, names and addresses of clients or potential clients who were sent educational materials during the years under examination.

XXX provides no meaningful education in its contacts with individuals expressing an interest in its service, the DMP. XXX alleges that it prepares a "budget" for consumers contacted. This "budget" information is only obtained in order to determine whether the individual will qualify for the DMP. No other purpose for this "budget" information was observed and XXX did not demonstrate that the information was used for any other purpose other than qualifying a potential client for the DMP. There is no actual "budget" counseling or significant education provided to consumers who contact, or are contacted by, XXX.

In addition, XXX has a substantial non exempt purpose of selling a product, the DMP. XXX is not furthering any charitable or educational purpose when it solicits clients for DMP's by purchasing leads and contacting consumers who visit its website requesting information on consolidating their debts. XXX advertises via its website and purchases leads in order to increase its business. Its employees were, at least partially, compensated based on the amount of business they brought in.

CONCLUSION

In summary, XXX was not operated exclusively for exempt purposes, because it did not engage primarily in activities that accomplish an exempt purpose, more than an insubstantial part of XXX's activities are in furtherance of a non-exempt purpose, XXX was operated for the purpose

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of serving a private benefit rather than public interests. Accordingly, it is determined that XXX is not an organization described in section 501(c)(3), and is not exempt from income tax under section 501, effective September 1, XXXX.

EXEMPT ORGANIZATION'S POSITION

XXX's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. XXX will be allowed 30 days to review this report and respond with a rebuttal if necessary.