



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201305011**
Release Date: 2/1/2013
Date: November 8, 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,

Holly O. Paz
Director, Exempt Organizations
Rulings and Agreements

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



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: September 19, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = date
E = state
F = individual
G = individual
H = individual
N = organization
O = business
P = business
q = dollar amount
r = dollar amount

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.

Issues

Do you meet the operational test 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 under E law. Your Articles of Incorporation indicate you are organized for 501(c)(3) charitable and educational purposes. Your Bylaws do not state any specific purpose.

You have three directors, F, G and H. F and G are related. All three directors are business professionals with sales and marketing experience. F also has over 20 years experience in the legal and credit field.

H will be paid no more than \$ _____ annually to attend meetings and F will be paid at least \$ _____ per month to service clients. F's actual rate will be based on the number of clients served and is projected in your budgets to be up to \$ _____ per year.

You will help repair credit ratings for your clients by correcting existing errors in credit reporting, removing unverifiable items and fraudulent entries on a client's credit report. You will work within the guidelines of the Fair Credit Reporting Act and are a member of N. You will begin by receiving forwarded copies of a client's credit report from all three of the major credit bureaus, and then examine each report.

You use a referral based system to attract clients. You will target families with children in school, church congregants, military families, veterans and home buyers. You will use real estate agents and mortgage brokers to find the home buyer clients. You expect that most of your referrals will come from non-profit agencies.

One of your credit repair specialists will contact your client within 24 hours of receiving their report. You will go over the reports in detail deciding which items to dispute. Your client will be able to access a detailed status of your progress 24 hours a day, seven days a week, at a password protected customer service web site.

Next you will work the case. This entails analyzing the client's credit history to identify disputable items and challenging negative items directly with the credit bureaus. This step may be repeated for each subsequent cycle.

You will draft letters to dispute negative items on the client's behalf, and encourage clients to dispute their own credit if they have the time and knowledge. However, your letters are expertly designed such that credit bureaus will accept the dispute and conduct an investigation.

Disputed items are investigated by the credit bureau. At the conclusion of the investigation, a new copy of the client's credit report is sent to them. Your client then forwards this new report to you and the cycle repeats itself. You estimate it typically takes six to twelve months for a client to improve their credit scores.

You provided a copy of your client service contract. You will charge a non-refundable set-up fee and a monthly service fee of q dollars per person; r dollars for two people. At the end of your verification program, and upon a client's request, you will reconcile your file against your verification performance. You will total the number of accounts deleted or corrected and multiply that times a set account value per client. If that amount is less than the total amount of monthly verification service fees paid the client is entitled to a refund.

You will offer an undisclosed discount to veterans, the unemployed or those with unforeseen financial difficulty. You will offer a sliding scale to low-income clients. However, you do not anticipate many of your clients will be low-income stating "typically persons with low income do not have a past credit history with the three major credit bureaus" and "would not be a candidate for (your) services." You will refer most of potential low-income clients to credit counseling organizations. And while you indicated you could waive fees from time to time, and offer discounted or reduced services, you did not fully explain how you would determine who qualified for these rates, the amount that would be waived, and if this applied to all your service fees.

You will not refuse services to anyone who needs assistance with credit restoration due to inability to pay. However, you also stated that you are "under a contractual obligation to pay Q, an unrelated for-profit entity, a monthly fee" to handle your clients and "if the hard cost is not at least covered, (you) would have to discontinue (your) services...."

You submitted a copy of your contract with Q. During the credit repair process, the investigation of the three credit reporting agencies will be performed by Q. You will pay Q a fee per client to administer their file, estimating this to be over \$ annually per client, and in a year, you estimate you will have between 200 and 300 clients.

Q will provide your client's services, a customer direct 800 number and a direct fax number for customer support. Q has assisted you in building a quality support system for your clients. You do not have any employees, counselor or staff members. You will out-source your clients to Q. As you grow, you may hire staff members.

Currently, you do not have a website to promote your services. You will give each client a username and password to a back office portal so the client can keep track of their account. The back office portal is maintained by Q on their website as part of your contracted services.

You do not attempt to educate your clients. You encourage "all clients to educate themselves on maintaining good credit scores" citing the many educational courses available on the web. If necessary, you will refer clients to credit counseling organizations or bankruptcy attorneys. You have an informal agreement with P, a law firm, regarding referring clients with possible bankruptcies. Your director, F, is currently discussing possible future free workshops regarding good credit habits with other non-profits and professionals. However, there are no set plans or written materials at this time.

You have projected almost % of your income will come from gross receipts from client service charges and fees. Of your projected expenses, over half will pay for compensation, salaries and professional fees, with another % budgeted for cost of sales. Cost of sales will consist mostly of third party companies that will help you perform parts of the investigation of the credit agencies and the repair of the individual's credit.

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(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(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) of the regulations defines the words "private shareholder or individual" in section 501 of the Code to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an applicant organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private

interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

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 Rev. Rul. 61-170, 1961-2 C.B. 112, an association composed of professional private duty nurses supported and operated a nurses' registry to help make the nurses' services more readily available to the general public. The association's bylaws stated that its specific purposes were to provide employment for its members as well as to organize an adequate and available nursing placement service for the community. Its membership was open to both registered and practical nurses who met specified requirements. The organization maintained a registry of its members showing their respective qualifications and the types of services they perform. Reference and placement from the register were made on a rotating basis upon request for nursing services. The association was operated primarily to afford greater employment opportunities for its members, and only incidentally for the benefit of the general public. This was evidenced by the fact that it drew its support primarily from members and was controlled by a board of trustees composed of professional nurses, without public participation of any kind. Thus, the association was not organized or operated exclusively for exempt purposes as described in section 501(c)(3) of the Code.

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.

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.

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."

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

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 Bethel Conservative Mennonite Church v. Commissioner, 746 F. 2d 388, 391 (7th Cir. 1984) the court considered how a medical plan conducted by a church affected its exempt status. In analyzing the facts of the case the court stated that "The facts in each case must be explored to ascertain the predominant or primary purpose for which the organization was formed, and also the manner of its operation."

In Church by Mail, 765 F. 2d 1387 (9th Cir. 1985), affg. TCM 1984-349, Tax Court concluded that the extent of the integration between the operations of a non-profit entity and related for-profit entities controlled by the non-profit directors precluded exemption. Furthermore, the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church".

In Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.) cert. denied, 488 U.S. 907, 109 S. Ct. 257, 102 L. Ed. 2d 246 (1988), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

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

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax exempt purpose. As the court stated:

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

In Solution Plus, Inc. v. Commissioner, T.C. Memo. 2008-21, the Tax Court held that a credit counseling organization was not exempt under section 501(c)(3) because it was not organized and operated exclusively for educational or charitable purposes and impermissibly served private interests. The organization was formed by an individual

with experience selling debt management plans. The founder and his spouse were the only members of the organization's board of directors. The organization did not have any meaningful educational program or materials 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 Tax 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, you fail the operational test.

Operational Test

To satisfy the 501(c)(3) operational test, an organization must establish that it is operated exclusively for one or more exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations. You failed to establish that you are operated exclusively for one or more exempt purposes.

Your Activities Are Not Educational

You do not operate a substantive on-going educational program. You do not attempt to educate your current clients. You encourage your clients to educate themselves using the internet. Like the organization in Solution Plus, *supra*, you do not help clients develop an understanding of the cause of their financial problems.

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 do not offer counseling sessions that are structured primarily to improve your clients' understanding of their financial problems or their skills in solving them. Instead, your operational focus is on generating client fees. Like the organizations described in Better Business Bureau, *supra*, Easter House, *supra*, and Solution Plus, *supra*, your activities have an underlying commercial motive that distinguishes your activities from those carried out by an educational organization.

Rev. Proc. 86-43, *supra*, states a 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." You failed to prove that your method of communication to your clients meets the standards of Rev. Proc. 86-43, *supra*.

Thus, you failed to establish that your activities are educational within the meaning of section 501(c)(3) of the Code.

Your Activities Are Not Charitable

You outsource most of your services. Therefore, most of your time and resources are devoted to marketing and supporting the services of a for-profit entity. This does not further charitable purposes as you do not limit your services to low-income individuals, thereby relieving the poor and distressed. You will not refuse services based on inability to pay. However, you admitted that most low-income individuals would not need your services and would be referred to other credit counseling agencies. While you plan to offer some free services sometime in the future, no specific details were provided and you will rely primarily on fees to produce revenue. 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.

Unlike the organizations in Consumer Credit Counseling Service of Alabama; *supra*, and Rev. Rul. 69-441, *supra*, you charge fees for most of your services. "[P]rimarily providing services for a fee ordinarily does not further charitable purposes." Solution Plus, *supra*.

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

A nonexempt purpose may be evidenced by activities that are conducted in a commercial manner or for a commercial purpose. In discerning whether an organization has a substantial nonexempt commercial purpose, courts focus on a number of factors related to the purpose and nature of the activities of how an organization conducts its business. See e.g., Bethel Conservative Mennonite Church, Arlie Foundation, B.S.W. Group, Living Faith, *supra*. An examination of your activities, pricing policies, funding

sources and competition with for-profit entities clearly indicate a substantial commercial purpose.

Your activities consist primarily of providing fee based credit repair. Although an organization is not disqualified from tax-exempt status solely because its primary activity constitutes a business, when it conducts a business with an apparently commercial character as its primary activity, "that fact weighs heavily against exemption." B.S.W. Group, *supra*.

You will outsource most of your activity to a for-profit entity, Q. In teaming with a for-profit entity, you become competitors with other for profits offering similar services. "Competition with commercial firms is strong evidence of the predominance of non-exempt commercial purposes." B.S.W. Group, *supra*, You will also refer possible bankruptcy clients to an existing for-profit law firm, P. Like the organization described in Old Dominion Box Co, *supra*, your operation for the benefit of private parties constitutes a substantial nonexempt purpose.

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.

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.

Your net earnings inure to the benefit of your director, F. You intend to pay F commissions on clients fees, which is non-fixed compensation based on business results. There is no upper limit on the amount of your directors' compensation. Compensation based on a percentage of revenues with no limit has been held to be inurement. People of God Community, *supra*.

Therefore, you have not established that your operations will not result in inurement to insiders.

Private Benefit

An organization is not organized or operated exclusively for exempt purposes unless it serves a public, rather than a private interest. See section 1.501(c)(3)-1(d)(1)(ii) of the regulations. It is unnecessary for us to determine that the payments to the for-profit entity Q are unreasonable. Church by Mail, *supra*. Your entire enterprise is carried on in such a manner as to substantially benefit Q.

You are controlled by a board of directors composed primarily of business professionals, without public participation of any kind. This indicates that you are operated for the benefit of your directors rather than the public, as in Rev. Rul. 61-170, *supra*. Your board of directors is composed entirely of persons who stand to gain

financially from your activities, unlike the organization in Rev. Rul. 69-441, *supra*, whose board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

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 failed to establish that your fees are reasonable, and did not fully substantiate a fee waiver policy.

Credit counseling organizations must be governed by a board controlled by persons representing the broad interests of the public rather than by persons who benefit from the organization's activities. Section 501(q)(1)(D). You do not have a board of directors that is controlled by persons who represent the broad interests of the public as required by section 501(q)(1)(D)(i).

You also fail to meet the requirements of sections 501(q)(1)(D)(ii) and (iii), which generally specify the percent of voting power that is allowed to be vested in financially interested persons.

Therefore, 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 do not meet the operational test because your activities are not educational or charitable. You are organized and operated for commercial purposes. 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. You do not serve a public rather than a private interest. Also, you do not meet qualifications under IRC 501(q). 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,

Holly O. Paz
Director, Exempt Organizations
Rulings & Agreements

Enclosure, Publication 892