Number: **201318034** **INTERNAL REVENUE SERVICE**

Release Date: 5/3/2013 **TE/GE TECHNICAL ADVICE MEMORANDUM**

Area Director, Area 4 TEGE Appeals
Los Angeles, CA

JAN 1 8 2012

Taxpayer's Name:

UIL: 9999.98-00

Taxpayer's Address:

Taxpayer's ID No.:

Year(s) Involved:

Conference Held:

LEGEND

Taxpayer=

Issue:

Whether the Commissioner, TE/GE, should exercise discretion to grant the Taxpayer relief under section 7805(b) of the Internal Revenue Code to limit the retroactive effect of revocation of its exempt status under section 501(c)(3).

Facts:

Application for Exemption

Taxpayer (then operating under a different name) incorporated as a non-profit in 1991 "to provide credit counseling services to the public." The following year, Taxpayer applied for exempt status, describing its activities on the Form 1023 as: credit rebuilding (removal of negative, inaccurate information on credit reports), debt consolidation (negotiating with creditors to reduce payments, interest charges, re-age accounts), counseling clients as to budgeting their income and paying their bills in a timely manner, and distributing a monthly newsletter.

Taxpayer used a proprietary software program developed by its president, and licensed from a for-profit entity owned by him. It also executed a "marketing agreement" with this for-profit entity to supply a number of services in addition to marketing and promotion: to hire and train sales agents, conduct all advertising, provide credit rebuilding services, computer programming and purchasing, design all brochures, manuals, phone scripts, question and answers, and videos. The agreement was exclusive. It provided for a payment of $ per month for each active customer and $ for each video tape sold.

The Service issued a proposed denial that Taxpayer was neither organized nor operated exclusively for exempt purposes because:

- The purpose expressed in its articles was too broad and did not describe an exempt purpose;
- It was operated as a trade or business ordinarily carried on for profit, to the general public, without regard to financial status; and
- It failed to demonstrate that no part of its net earnings would inure to the benefit of private individuals, due to the close connection with a for-profit owned by the president.

In response, Taxpayer informed the Service of certain changes, stating with respect to the marketing agreement:

> The relationship described in the initial Form 1023...under which a for profit corporation owned by the President does marketing for [Taxpayer] would not be utilized. Instead, [Taxpayer] would be responsible for its own marketing.

Taxpayer submitted revised Articles of Incorporation restating its purposes as follows:

- To help reduce personal bankruptcy by informing the general public on personal money management and consumer credit counseling;
- To aid low income or unemployed individuals and families with fiscal problems;
- To assist low income or unemployed individuals with debt consolidation and participate in corporate fair share programs.

Based upon these representations, the Service issued a favorable determination letter. The approval letter included a paragraph describing the changes and additional representations:

> You have amended the purpose clause, added a dissolution clause, and made other changes in your articles of incorporation.....You represent that your services will be provided to those who are considered in need of charity, such as low income individuals. You also represent that you will be responsible for the marketing of your services.
>
> Based on the additional information supplied to us and assuming your operations will be as stated in your application...we have determined you are exempt....

Examination

The facts developed during the examination of FY20 showed that, six years after it was recognized as exempt, Taxpayer contracted with the same related for-profit entity for the same services described above plus additional services, constituting nearly all of its operations. The examination also concluded that Taxpayer primarily marketed and enrolled individuals in debt management plans ("DMPs"). It did not primarily counsel individuals or families about personal finance, budgeting or credit. The telephone calls only screened potential customers for the ability to make payments that met creditors' requirements for a DMP. Taxpayer did not report these changes in operations to the Service.

Taxpayer appealed the proposed revocation. Appeals sustained the revocation. Following the appeals process, the National Office received this request for relief from retroactive revocation as a mandatory TAM.

Law:

Section 7805(b)(8) of the Code provides that the Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.

Section 1.501(a)-1(a)(2) of the Income Tax Regulations (regulations) states that an organization that has been determined by the Commissioner to be exempt under section 501(a) may rely upon such determination so long as there are no substantial changes in the organization's character, purposes, or methods of operation, and subject to the Commissioner's inherent power to revoke rulings because of a change in the law or regulations, or for other good cause.

Section 301.7805(b)-1 of the Procedure and Administration Regulations provides that the Commissioner may prescribe the extent to which any ruling issued by his authorization shall be applied without retroactive effect.

Rev. Proc. 2011-5, 2011-1 I.R.B.167 in section 4.04 states that all requests for relief under section 7805(b) of the Code must be made through a request for technical advice (TAM). Section 19.04 states further that when, during the course of an examination by EO Examinations or consideration by the Appeals Area Director, a taxpayer is informed of a proposed revocation, a request to limit the retroactive application of the revocation must itself be made in the form of a request for a TAM and should discuss the items listed in section 18.06 as they relate to the taxpayer's situation.

Section 18.06 of Rev. Proc. 2011-5 provides, in part, that generally a TAM that revokes a determination letter is not applied retroactively if:

(1) there has been no misstatement or omission of material facts;
(2) the facts at the time of the transaction are not materially different from the facts on which the determination letter was based;
(3) there has been no change in the applicable law; and
(4) the taxpayer directly involved in the determination letter acted in good faith in relying on the determination letter, and the retroactive revocation would be to the taxpayer's detriment.

Rev. Proc. 2011-9, 2011-2 I.R.B. 283, sets forth procedures for issuing determination letters (from EO Determinations) and rulings (on applications for recognition of exempt status by EO Technical) on the exempt status of organizations under section 501. These procedures also apply to revocation or modification of determination letters or rulings.

Section 12.01 of Rev. Proc. 2011-9, states, in part, that the revocation or modification of a determination letter or ruling recognizing exemption may be retroactive if the organization omitted or misstated a material fact, or operated in a manner materially different from that originally represented. In certain cases an organization may seek relief from retroactive revocation or modification of a determination or ruling under section 7805(b) of the Code using the procedures set forth in Rev. Proc. 2011-4, which further refers to Rev. Proc. 2011-5, sections 18 and 19.

Section 12.01(1) of Rev. Proc. 2011-9, states that where there is a material change inconsistent with exemption in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change.

In Automobile Club of Michigan v. Commissioner, 353 U.S. 180, 184 (1957), the Supreme Court held that the Commissioner has broad discretion to revoke a ruling retroactively. It further held that a retroactive ruling "may not be disturbed unless ... the Commissioner abused the discretion vested in him." 353 U.S. at 184.

In Stevens Bros. Foundation, Inc. v. Commissioner , 324 F.2d 633, 641 (1963) the court found "far from convincing" the Foundation's efforts to demonstrate that its information reports were adequate and sufficient to apprise the Commissioner of its entry into the business activities which led to denial of its tax exempt status. 324 F.2d at 641. Shortly after receiving its tax-exempt ruling, the Foundation contracted with a for-profit company, but failed to disclose this fact to the Commissioner on its Forms 990. The court upheld the Service's retroactive revocation.

In Variety Club Tent No. 6 Charities, Inc. v. Commissioner, T.C. Memo 1997-575 (1997), the court held that petitioner "operated in a manner materially different from that originally represented." The organization represented in its exemption application and articles of incorporation that no part of its net income would inure to the benefit of any private shareholder or individual. But the court found instances of inurement over several years, and upheld the Service's retroactive revocation for such years.

Analysis:

During the year under exam, Taxpayer's operations were materially different from the description it provided in its exemption application. See Variety Club Tent No. 6 Charities, T.C. Memo 1997-575; Rev. Proc. 2011-9, § 12.01. Taxpayer primarily marketed and enrolled individuals in DMPs, screening potential clients based on the creditors' requirements. It did not ascertain, or provide education and services tailored to, the financial needs and circumstances of the general public. After receiving its determination letter, it once again contracted with the for-profit company wholly-owned by its president to conduct most of its operations, contrary to what it represented in the application process. Finally, Taxpayer did not fully apprise the Service of these material changes. See Stevens Bros. Foundation, 324 F.2d at 641 (failure to adequately and sufficiently inform the Service of material changes in operations). Therefore, revocation may be retroactive to the year under examination, when the Service determined Taxpayer had made material changes in its operations. See Automobile Club of Michigan, 353 U.S. at 184 (Commissioner has broad discretion to revoke a ruling retroactively); Rev. Proc. 2011-9, § 12.01(1) (revocation ordinarily applies as of the date of material changes in operations).

Conclusion:

The Commissioner, TEGE, has declined to exercise discretion tc limit the retroactive effect of revocation of Taxpayer's exempt status under section 501(c)(3). Revocation is effective as of the first day of tax year 20 .