

INTERNAL REVENUE SERVICE

TE/GE TECHNICAL ADVICE MEMORANDUM

Release Number: 201419018

DEC 31 2013

Release Date: 5/9/2014

UIL Code: 4975-0402

Taxpayer's Name:

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 § 7805(b) of the Internal Revenue Code to limit the retroactive effect of the revocation of its exempt status under § 501(c)(3).

FACTS:

Application for Exemption

The Taxpayer applied for tax-exempt status, describing its activities on the Form 1023. It stated that it was formed to educate the public about personal money management skills and assist needy, predominantly low-income individuals and families with their financial problems. To achieve this objective, Taxpayer stated that it would engage in the following activities:

When Taxpayer submitted the Form 1023, it also represented that it would initially spend about percent of its time, effort, and resources on activity (1),

relating to providing information. It estimated that it would spend about percent of its time, effort, and resources on Activity (2), relating to counseling. It estimated that the remainder of its time and resources would be spent on activity (3), relating to budget planning. Eventually, these percentages would change to percent for activity (1), percent for activity (2), and percent for activity (3).

Taxpayer expected about percent of its revenue to come from "voluntary payments" from creditors and clients participating in its budget plans.

Based upon these representations, the Service issued a favorable determination letter to Taxpayer.

Examination

The examination concluded that substantially all of Taxpayer's activities during the years under examination consisted of DMP sales conducted through telemarketing and use of lead providers. It evaluated employees based on the number of DMPs they sold. Furthermore, Taxpayer did not counsel or educate individuals or families about personal finance, budgeting, or credit. The examination found that, while Taxpayer made a few presentations to local schools via the telephone, it had little other educational activity. The telemarketing calls Taxpayer made only screened potential customers for the ability to make payments that met creditors' requirements for a DMP. Taxpayer did not report these changes in operation 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.

Legal Standard:

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

Rev. Proc. 2013-5, 2013-1 I.R.B.170 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 of Rev. Proc. 2013-5 lists the criteria necessary for granting section 7805(b) relief as well as the effect of such relief. Section 18.06 states, in part, that 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. 2013-9, 2013-2 I.R.B. 255, 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. 2013-9, 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. 2013-4, which further refers to Rev. Proc. 2013-5, §§ 18 and 19.

Section 12.01(1) of Rev. Proc. 2013-9, 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. 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*, 74 T.C.M. (CCH) 1485 (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 years under exam, Taxpayer's operations were materially different from the description it provided in its exemption application. See *Variety Club Tent No. 6 Charities*, 74 T.C.M. (CCH) 1485; Rev. Proc. 2013-9, § 12.01. Taxpayer's only substantial activity was marketing and enrolling individuals in DMPs, screening potential clients based on the creditors' requirements. Although it had represented in its Form 1023 that it would perform substantial educational activities, Taxpayer did not ascertain, or provide education and services tailored to, the financial needs and circumstances of the general public. Finally, Taxpayer did not 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. 2013-9, § 12.01(1) (revocation ordinarily applies as of the date of material changes in operations).

CONCLUSION:

The Commissioner, TEGE, has declined to exercise discretion to limit the retroactive effect of revocation of exempt status under § 501(c)(3). Revocation is effective as of the first day of the first tax year for which it was examined.