

Internal Revenue Service

Appeals Office

Release Number: 201541012

Release Date: 10/9/2015

Date: June 12, 2014

**Officer
Name
Street
City, State, Zip**

Department of the Treasury

Employer Identification Number:

EIN

Person to Contact:

Employee ID Number:

Tel:

Fax:

UIL: 501.03-30

Certified Mail

Dear :

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 XX/XX/XXXX.

Our revocation was made for the following reasons:

1. You are not operated exclusively for charitable, educational, scientific, or any other exempt purpose, as is required by IRC section 501(c)(3).
2. You are operated for a substantial commercial purpose, which is not an exempt purpose.
3. You are operated for a substantial private purpose, you serve private rather than public interests, and your activities result in substantial private benefit, 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. 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 the adverse determination, 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.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

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,

Acting Appeals Team Manager

cc:

Enclosure: Publication 892 and/or 556



DEPARTMENT OF THE TREASURY
Internal Revenue Service
WASHINGTON, DC 20224

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Date: September 30, 2005

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact: / ID Number:

Contact Number:

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.


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,


R. C. Johnson,
Director, EO Examinations

ENCLOSURES:

Publication 892

Publication 3498

Report of Examination: Form 4621, Form 886-A, Form 6018

Cc: Power of Attorney
Power of Attorney

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer ORG		Year/Period Ended June 30, 20XX

LEGEND

ORG - Organization name XX - Date Address - address City - city
State - state Country - country BK-1 through 17 - 1st through 17th BK
President - president Vice President - vice president Secretary - secretary
DOF - DOF DOTS - DOTS DOBD - DOBD DOES - DOES
NEWS-1 & NEWS-2 - 1st & 2nd NEWS WK-1 through WK-3 - 1st through 3rd WK
DIR-1 through DIR-9 - 1st through 9th DIR CO-1 through CO-53 - 1st through 53rd COMPANIES
ART-1 through ARTL-4 - ARTL1 - ARTL-4 Software - Software

ISSUES

In response to Congressional concern over alleged abuses in the consumer credit counseling industry, the Internal Revenue Service initiated a compliance project in which certain consumer credit counseling organizations exempt under Internal Revenue Code section 501(c)(3) were selected for a field examination. As a result, ORG was selected for examination.

The year under examination is the year ended June 30, 20XX, and the issue raised herein is as follows:

Whether ORG remains operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3), if:

- (a) It is engaged primarily in activities that accomplish a nonexempt purpose in contravention of Internal Revenue Code sections' 501(c)(3) and 170(c)(2)(B);
- (b) More than an insubstantial part of such activities are in furtherance of a non-exempt purpose in contravention of Internal Revenue Code sections' 501(c)(3) and 170(c)(2)(B);
- (c) Part of its net earnings inured to the benefit of any private shareholder or individual in contravention of Internal Revenue Code sections' 501(c)(3) and 170(c)(2)(B); and
- (d) It is operated for the purpose of serving private rather than public interests in contravention of Internal Revenue Code sections' 501(c)(3) and 170(c)(2)(B).

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Name of Taxpayer ORG		Year/Period Ended June 30, 20XX

I. STATEMENT OF FACTS

A. General Background Information

1. Formation of ORG

a. Origins

ORG ("ORG") began operating as CO-1 on January 4, 19XX. It offered credit restoration services and debt consolidation to residents of southern State. As business expanded, ORG was created, specializing in debt consolidation.

b. Entity Type

ORG was formed on April 1, 19XX in the State of State as a non-profit corporation, pursuant to Chapter 617 of the State statutes.¹ The initial articles of incorporation provide that the purpose of ORG is to conduct financial consulting services as its principal activity.

c. Principal Place of Business

ORG's principal place of business where such financial consulting service activities were initially conducted was Address, City, State. Later, ORG relocated to Address, City, State. ORG's current address is Address, City, State.

d. Incorporators

The names and addresses of the incorporators/initial directors are listed below:

Name	Address
PRESIDENT, Co-Chairman and Registered Agent	Address, City, State.
DIR-1, Co-Chairman	Address, City, State.
DIR-2, Director	Address, City, State.
DIR-3, Esq., Director	Address, City, State.

2. The Application Process for Exemption Under IRC 501(c)(3)

* * * *

¹ The original name is ORG but the word " " was subsequently corrected on May 13, 19XX.

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a. Submission of Exemption Application

ORG submitted Form 1023, "Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code," to the Internal Revenue Service ("IRS"), Employment Plans/Exempt Organizations Division (now known as Tax Exempt/Government Entities Division), City Key District Office in City, State. The application was signed by PRESIDENT as Director of ORG and was received by the IRS on June 21, 19XX.

b. Proposed Primary Activities

ORG sought exemption from Federal income tax under Internal Revenue Code section 501(c)(3) as an organization proposing to provide credit counseling and debt consolidation services to the general public. ORG submitted a more detailed description of such proposed activities as Attachment I to its Form 1023 application, which provides:

A) ORG is dedicated to helping individuals who are experiencing financial difficulties.

The corporation's main service will consist of bill consolidation. This program is targeted to individuals with unsecured debt that has become unmanageable. Our focus is to consolidate these bills by lowering monthly payment commitments. Generally, participants in this program will realize a savings of 20-50% on a monthly basis through a system of negotiations with their creditors.

Advantages to participants of the Debt Management Program are as follows:

- 1) Lower – more affordable monthly payments*
- 2) Re-aging of past due accounts to a current status, thus having a positive effect on the client's credit rating.*
- 3) Lowering or even waiving in certain situations; all interest and penalty assessments.*

In addition, the agency offers other services consisting of investment counseling, courses on the development of a family budget, a quarterly newsletter with information consisting of financial information to health tips. The agency also will operate a financial consulting "hot line" which clients may call and receive expert advice on the use of income in the course of everyday life. Additionally, the agency will administer a scholarship program based on need.

B) The above referenced activities will be initiated starting in the Fall of 19XX.

C) Activities will be conducted in City and Counties in the State of State. Initially operated duties will be conducted by the members of the Board of Directors until a full-time staff can be put in place.

c. Proposed Secondary Activity

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Pursuant to Attachment III of its Form 1023 application, ORG also proposed to provide scholarship grants to students:

The dollar amount of the scholarship will be determined by the Board of Directors. The amount of the scholarship will directly correlate with the fund raising activities of the organization. The Board of Directors expect to grant scholarships in the amount of at least \$.

To be considered for a scholarship, the candidate must have maintained a cumulative grade point average of 3.0 on a scale of 0.0 to 4.0 in their primary education. In addition, an investigation into the candidates financial affairs will be performed to coincide with the programs requirements that the scholarship be based on need.

d. Qualifying as a Publicly Supported Organization

With respect to foundation status, ORG provided that it was not a private foundation, because it qualified as a publicly supported organization under Internal Revenue Code section's 509(a)(1) and 170(b)(1)(A)(vi). To qualify as a publicly supported organization, ORG indicated that its sources of financial support would consist of corporate contributions and financial grants.

ORG also stated that a third source of revenue would be a service fee assessed to individuals participating in its Debt Management Program:

A small, flat, up front, one-time fee will be charged to participants in the Debt Management Program. This fee will cover processing costs that are associated with activating the client's file in the Debt management Program. An additional fee of \$ will be assessed each month to the participants enrolled in the program. This monthly fee will cover the cost of the financial consulting "hot line", investment counseling, courses on family budgeting, and a quarterly newsletter that will be forwarded to each participant in the program.

e. IRS Correspondence during the Exemption Application Process

On July 1, 19XX, the IRS returned ORG's Form 1023 application for the following reasons:

- ORG did not submit a conformed copy of its articles of incorporation.
- ORG did not submit a copy of its bylaws.

In a follow-up letter, dated July 29, 19XX, the IRS requested ORG to amend its articles of incorporation to meet the organizational test of Treasury Regulations section 1.501(c)-(3)1(b). In response to the July 29 letter, ORG amended its articles of incorporation on August 18, 19XX by added the following provision as Article VIII:

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a. The purposes for which the corporation is organized are exclusively religious, charitable, scientific, literary and educational 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.

b. Notwithstanding any other provision of these articles, this organization shall not carry on any activities not permitted to be carried on by an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1986 or the corresponding provision of any future United States Internal Revenue law.

c. Upon dissolution of the organization, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1986, or corresponding section of any future Federal tax code, or shall be distributed to the Federal, state or local government for a public purpose. Any such assets not so disposed of shall be disposed of by the Court of Common Pleas, of the county in which the principal office of the organization is then located, exclusively for such purposes.

3. Recognition of Exemption Under 501(c)(3)

a. Advanced Ruling

In exemption ruling Letter 1045, dated September 9, 19XX, the IRS advised ORG that it is exempt from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Internal Revenue Code section 509(a)(2) and will be treated as such during the advanced ruling period.

b. Confirmation of Status as a Publicly Supported Organization

After the end of the advanced ruling period, the IRS issued foundation status Letter 1050, dated May 12, 19XX, stating that based on information received, ORG is not a private foundation within the meaning of IRC 509(a).

4. Subsequent Changes to the Articles of Incorporation

On January 3, 19XX, ORG amended and restated its Articles of Incorporation. The purposes for which ORG was organized are as follows:

The purposes of the Corporation are to operate exclusively as a charitable corporation within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, or corresponding provisions of any later Federal tax laws (the "Code"), by providing assistance to individuals who are experiencing financial and debt-related difficulties. In furtherance of such purposes, the Corporation may, inter alia, provide (i) bill consolidation services; (ii) counselling on credit and budget matters; and (iii) a newsletter on financial related issues. The Corporation may engage in any lawful activity or transact any lawful business for which corporations may be incorporated under the State Not-For-Profit Corporation Act, not inconsistent with those exercisable by a corporation in conformance with Section 501(c)(3) of the Code. Moreover, all

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funds of the Corporation and any monies from its operations shall be used in the furtherance of the purposes set forth above, and no benefits shall inure to any private parties, except benefits incidental to the purposes and objectives of the Corporation. All powers exercised herein shall be in furtherance of the purposes set forth above and shall at times be in conformance with the provisions of Section 501(c)(3) of the Code.

5. Tax Year Under Examination

ORG, a fiscal year taxpayer whose fiscal year ends June 30, files annually a Form 990, Return of an Organization Exempt From Income Tax Under section 501(c). Their Form 990 is under the examination jurisdiction of the IRS Tax Exempt/Government Entities Division, Mid-Atlantic Area. The year under examination and at issue herein is the fiscal year ended June 30, 20XX.

B. Background Information on the Consumer Credit Counseling Industry

1. Exemption Status of Credit Counseling Organizations

The IRS recognized a credit counseling agency open to the general public as exempt under Internal Revenue Code section 501(c)(4) in Revenue Ruling 65-299, 1965-2 C.B. 165. The agency was incorporated as a nonprofit corporation to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. The agency was recognized as exempt under section 501(c)(4), because it:

- did not limit its services to those in need of such assistance as proper recipients of charity;
- employed specialists to interview applicants, analyze the specific problems involved, and counsel applicants on the payment of their debts;
- arranged a monthly distribution to creditors based on the debtor's ability to pay;
- communicated with creditors and, with the creditors' consent, set up plans which debtors agreed to follow;
- made its facilities available for debtors to make their monthly pro rata distributions to creditors;
- made no loans to applicants nor negotiated loans on their behalf;
- charged nominal fees to cover postage and supplies for its monthly prorating services;
- charged no fees for the counseling service; and
- relied upon voluntary contributions from local businesses, lending agencies, and labor unions to cover its costs of operations.

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By 1969, the IRS determined that certain credit counseling organizations might meet the requirements of Internal Revenue Code section 501(c)(3) because of their charitable or educational work. In Revenue Ruling 69-441, 1969-2 C.B. 115, a credit counseling agency was recognized as exempt under Internal Revenue Code section 501(c)(3).

This agency limited its services to low-income individuals and families with financial problems. Its board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

To qualify for exemption under Internal Revenue Code section 501(c)(3), the agency:

- provided educational information to the general public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications;
- assisted low-income individuals and families with financial problems by providing them with individual counseling and, if necessary, by establishing budget plans;
- serviced the budget plan by allowing the debtor to voluntarily make fixed payments through the agency; holding the funds in a trust account and disbursing the funds on a partial payment basis to the creditors, whose approval was obtained in advance;
- made no loans to debtors or negotiated loans on their behalf;
- charged no fees for counseling services or proration services - the debtor received full credit against his/her debts for all amounts paid; and
- relied upon voluntary contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The IRS distinguished the facts in this ruling from the facts in Revenue Ruling 65-299 that held the organization was exempt under Internal Revenue Code section 501(c)(4):

- The agency in Revenue Ruling 65-299 was not engaged in any educational activities.
- The agency in Revenue Ruling 65-299 did not limit its assistance to a charitable class -- families or individuals in need of such assistance as proper recipients of charity.

In the 1970s, the courts held that a credit counseling organization may be exempt from Federal income tax even if it does not limit its clientele to low income individuals where the services provided by the organization are educational in nature. By ruling so, the courts reversed the IRS in its revocation of the exempt status of two organizations that provided credit counseling, but did not limit their services to low-income individuals.

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The CO-2 and the CO-3 (Agencies) were umbrella organizations made up of numerous individual CO-3. Both had been recognized as exempt under Internal Revenue Code section 501(c)(3), and the activities of both organizations were similar as follows:

- The 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.
- The Agencies also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families but did not limit these services to low-income individuals and families.
- The Agencies charged a nominal fee of up to \$ per month for some of their services, but waived the fee in instances where payment would work a financial hardship.
- The Agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the CO-4. An incidental amount of their revenue was from the counseling fees. This was consistent with the fact that only 12 percent of the professional counselors' time was spent on debt management programs as opposed to education. The balance of time was devoted to the educational programs.
- The Agencies were controlled by a community board of directors. The boards were required to have at least a 60 percent representation of the general public.
- The Agencies were not controlled by or the captive of any creditor.

In 1976, relying on Revenue Rulings 65-299 and 69-441, the IRS notified the Agencies that it had made a mistake and was reclassifying them under Internal Revenue Code section 501(c)(4). What followed are two pivotal declaratory judgment (IRC 7428) cases: CO-2 of Alabama v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978) and CO-3 of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979).

The law does not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under Internal Revenue Code section 501(c)(3). Organizations may be properly designated under Internal Revenue Code section 501(c)(3) notwithstanding the fact that the general public is served.

Nonetheless, the Agencies do not charge a fee for the programs that constitute their principal activities. A fee may be charged for a service that is an incidental part of an agency's function, but even where a fee is so charged it is nominal. Moreover, even this nominal fee is waived where payment would work a financial hardship.

2. Problems in the Industry

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The consumer credit counseling industry arose as a means of assisting individuals to pay their credit card debt without resorting to bankruptcy and a means of enabling creditors to collect debt that otherwise would be discharged in bankruptcy. Through the 1980s the industry was financially supported almost entirely by creditors, which returned to the industry approximately 15% of the money they received through the efforts of the industry.

Over the last decade, however, the industry has changed significantly. Responding to the dramatic increase in credit card debt, a new generation of credit counseling agencies arose. These new credit counseling agencies pioneered more business-like methods of making debt management plans convenient for consumers, including flexible hours, phone and Internet counseling, and electronic payments. As the newer agencies have gained market share, a number of serious problems have surfaced as well. A report of two prominent consumer organizations (CO-5 and the CO-6) has documented the situation. The problems include

- provision of only debt management plans;
- aggressive sometimes deceptive marketing practices and selling techniques concerning the nature of, the need for, and the cost of debt-management plans;
- lack of face-to-face or individualized contact with consumers;
- excessive cost to consumers; and
- undisclosed related party transactions.

These problems are compounded by a drastic reduction in support for the industry by its traditional benefactors, the issuers of credit cards. This has led counseling agencies to impose on consumers an increasing share of the cost of their operations.

3. Involvement of the Federal Trade Commission

In response to the problems in the consumer credit counseling industry, the Federal Trade Commission interceded through law enforcement and educational efforts to protect consumers from unfair or deceptive acts or practices that are in or affect commerce.

In Commission testimony² submitted before the Senate Committee on Governmental Affairs, the Permanent Subcommittee on Investigations, FTC Commissioner Thomas Leary cautioned that some companies use their non-profit status as a badge of trustworthiness to attract customers, who are then duped into paying large fees. Those fees are sometimes funneled to for-profit companies.

* * * *

² *Prepared Statement of the Federal Trade Commission On Consumer Protection Issues in the Credit Counseling Industry*. Presented by Commissioner Thomas B. Leary Before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate (March 24, 20XX).

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Leary explained that instead of teaching consumers about their finances and how to manage debt as it promised, some credit counseling organizations indiscriminately enroll their clients in "debt management plans" without regard to their particular financial situation. This kind of debt management – under which consumers pay debt managers who then pay their creditors – can be beneficial for some consumers, but not for all. "Along with these changes in the industry have come complaints about troubling practices, including possible deception about the services offered, poor administration of DMPs, and undisclosed fees associated with DMPs," Leary said.

Leary stated that the FTC's greatest concern is deception by credit counseling organizations about the nature and costs of their services, including the following practices:

- Failure to pay creditors in a timely manner or at all. Some credit counseling agencies that offer debt management plans may fail to pay creditors in a timely fashion or at all. This can result in serious consumer harm, such as late fees that the creditors impose.
- Promises of results that cannot be delivered. Some agencies promise that they will lower consumers' interest rates, monthly payments, or overall debt by an unrealistic amount. Some also make false promises to eliminate accurate negative information from consumers' credit reports.
- Failure to abide by telemarketing laws. To the extent that these agencies are not bona fide non-profit organizations, they must comply with the FTC's Telemarketing Sales Rule, including the National Do-Not-Call Registry.

4. Internal Revenue Service Compliance Project³

IRS officials also became concerned that some credit counseling organizations that might have qualified for exemption status in the past may no longer qualify due to changes in the services they provide. This problem is magnified because the organizations, by reason of their tax exemption, are exempted from many state and federal consumer protections.

For example, the Credit Repair Organization Act of 1997 sought to further regulate the practice of for-profit organizations involved in "credit repair," a series of activities aimed at improving a customer's credit history. But the Act excluded credit counseling organizations exempt under Internal Revenue section 501(c)(3) from the provisions of this law. A similar pattern of exceptions for tax-exempt organizations is replicated in many state consumer laws.

The IRS is concerned that the combination of tax-exempt status and exemption from consumer protections may leave certain taxpayers vulnerable. To address this concern, the Exempt Organizations office of the IRS initiated a compliance project to address concerns in this area.

* * * *

³ *IRS Takes Steps to Ensure Credit Counseling Organizations Comply With Requirements for Tax-Exempt Status*, Internal Revenue Service Newswire, FS-20XX-17, October 20XX (website)

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C. Financial Statements and Data

1. Appointment of Independent Auditor

ORG appointed CO-7, an independent accounting firm based in City, State, to audit ORG's statements of activities, financial position and cash flows and to prepare its Form 990 information return and the accompanying schedules and statements for the fiscal years ending June 30, 20XX, 20XX, 20XX and 20XX.

In its report, CO-7 stated that the audits were conducted in accordance with auditing standards generally accepted in the United States and that the financial statements referred to above presented fairly, in all material respects, the financial position of ORG as of June 30, 20XX, 20XX, 20XX and 20XX and the results from its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

2. Significant Accounting Policies

a. Financial Reporting

The financial statements of ORG have been prepared on the accrual basis of accounting, where receipts are recognized as revenues when earned and expenses are recorded when incurred.

b. Fiscal Year End

ORG's fiscal year end is June 30.

3. Summary Results from Operations

The summary results from operations for the year ended June 20, 20XX are provided in Table 1 below:

Table 1
Form 990 - Summary Statement of Revenue, Expenses & Excess for the Year

Revenue	
Expenses	
Excess for the year	
Net assets or fund balances, July 1, 20XX	
Other changes in net assets or fund balances	
Net assets or fund balances, June 30, 20XX	

4. Analysis of Revenues

a. Two Primary Sources of Income

During the year under examination, ORG received substantially all of its revenues from two sources: fairshare income and membership dues, as provided in Table 2 below. ORG describes fairshare income as revenues derived from their provision of debt adjustment services, the cost of which is

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supported by contributions from the creditor community and membership dues. In contrast, income from membership dues are revenues derived from consumers participating in ORG's debt management program. ORG states that the fees are based on need but are otherwise mandatory in order to participate to participate in the program.

Table 2
Form 990 - Sources of Revenues

Revenue	Total	% of Revenues
Fairshare income		
Debt management fees		
Interest on savings and temporary cash investments		
Dividends and interest from securities		
Total Revenue		

b. Trends in Revenue from Fair Share and Debt Management Fees

Table 3 shows ORG's sources of revenues for the five-year period ending in fiscal year June 30, 20XX.

Table 3
Form 990 - Sources of Revenues

Revenue	30-Jun 19XX	30-Jun 20XX	30-Jun 20XX	30-Jun 20XX	30-Jun 20XX
Fair share income					
Debt management fees					
Interest on savings					
Dividends and interest					
Total Revenue					

In glancing at the data in Table 3, revenues from fair share and debt management fees have both increased steadfastly and sequentially. A true measure of revenue growth, however, is to express each source of revenue as a percentage of total revenue using the formulas provided in Table 4 below:

Table 4
Formulas: Revenues from Fair Share and Debt Management Fees as a Percentage of Total Revenue

$\text{Fair Share Income} / \text{Total Revenue}$	$\text{Debt Management Fees} / \text{Total Revenue}$
---	--

These formulas indicate how income from fair share and debt management fees are changing relative to changes in total revenue. As total revenue increases, it might be expected that income from fair share and debt management fees would increase proportionately; therefore, the level of income from fair share and debt management fees should at least remain constant in real terms.

Illustration 1
Income from Fair Share and Debt Management Fees
(as a % of Total Revenue)

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TABLE DELETED

As the graph in Illustration 1 above indicates, two distinct trends are evident: First, revenue from fair share as a percentage of total revenue between 19XX and 20XX has declined from nearly 62 percent in fiscal year 19XX to nearly 43 percent in fiscal year 20XX, as provided in Table 5 below. This trend reflects the industry-wide creditor reduction of percentages paid to the credit counseling agencies. The result today is an average fair share contribution of only about six percent, or about a sixty percent reduction over the past seven years.⁴

Table 5
Ratio of Fairshare Income to Total Revenue
For the Years Ended June 30

	19XX	20XX	20XX	20XX	20XX
Ratio of Fairshare Income to Total Revenue					

The second trend evident during the five year period is the growth of debt management fees as a percentage of total revenue from approximately 36 percent in 19XX to approximately 57 percent by 20XX, as provided in Table 6 below and depicted in Illustration 1 above. According to the testimony of DIR-4, the effect of reduced fair share support has been twofold:

To survive, credit counseling agencies have had to reduce traditional services or they have had to pass more of the costs for providing services on to consumers, or both. More recently, creditors have increasingly recognized that agencies which emphasize debt management plans and charge excessive fees are not operating in the best interests of either consumers or creditors and have terminated fair share contributions for such agencies.

Table 6
Ratio of Debt Management Fees
For the Years Ended June 30

	19XX	20XX	20XX	20XX	20XX
Ratio of Debt Management Fees to Total Revenue					

These trends have led ORG to shift its operational dependency from fair share income to debt management fees. To maintain existing service levels, ORG raised fees and hired additional credit counselors to respond to inquiries from the general public regarding debt relief.

5. Breakdown of Expenses

* * * *

⁴ *Non-Profit Credit Counseling Organizations: Hearing Before the Subcommittee on Oversight of the Committee on Ways and Means, 108th Congress, 1st Session 27 (20XX) (statement of DIR-4, President, CO-8).*

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Table 7 below sets forth ORG's statement of functional expenses, as filed with the IRS.

Table 8 below sets forth the changes in expenses from the fiscal year ending June 30, 20XX to the fiscal year ending June 30, 20XX. For each fiscal year, the table also expresses each expense item as a percentage of total revenue.

6. Description of Certain Expenses

a. Public Awareness

As shown below, for the fiscal year ending June 30, 20XX, ORG reported \$ in public awareness expense. This expense category represents the advertising (or marketing efforts) of ORG to utilize various media outlets in reaching out to consumers that are concerned over their personal finances. ORG provides that its main goal of its public awareness efforts is to attract the most debtors with poor credit management habits and attempt to modify their behavior with education and counseling.

b. Education Expense

As shown below, ORG reported \$ in education expense of which approximately \$ represents payments to CO-9, a related entity. In exchange for the fees, _____ produced publications for ORG, such as ORG's monthly newsletters and a book on debt management.

c. Client Support

In January 19XX, ORG outsourced its back office administrative operations to an organization named CO-10 The founder and sole owner of CO-10 is PRESIDENT, founder, president and chairman of ORG. For the fiscal year ended June 30, 20XX, ORG paid CO-10 \$ for the administrative services it provided.

7. Statement of Financial Position

Table 9 below sets forth ORG's statement of financial position as of June 30, 20XX.

8. Description of Certain Assets

a. Other Assets

As of June 30, 20XX, this asset category is comprised of the following items:

Item Description	Notes	Amount
Cash, Restricted		
Security Deposits		
Division Line Acquisition, Net		
Life Insurance Plans		
Prepaid Expenses		
Employee Advances		_____
Total		=====

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(A) Restricted cash represents the funds of clients held in escrow for the payment of unsecured debt.

b. Land, Building & Equipment

Leasehold improvements represent improvements ORG made to the property it leases. Leasehold improvements are capitalized and depreciated over its useful life.

Description	Date Acquired	Cost or Other Basis	Accumulated Depreciation	Book Value
Leasehold Improvements	01-01-19XX			
Leasehold Improvements	01-01-19XX			
Leasehold Improvements	01-01-20XX			
Leasehold Improvements	06-15-20XX			
Leasehold Improvements	07-01-20XX			

Table 7
Form 990 - Statement of Functional Expenses
For the Year Ended June 30, 20XX

Description	Total Expense	%	Program Services Expense	%	Mgmt & General Expense	%
Other salaries and wages						
Payroll taxes						
Legal fees						
Telephone						
Occupancy						
Printing and publications						
Depreciation, depletion						
Other expenses (itemize):						
Amortization Expense						
Vehicle Expense						
Charitable Donations						

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Insurance
Consulting Fees
Client Support
Bad Debts

Table 8
Percentage Change in Expenditures

For the Year Ending June 30

Description	20XX	%*	20XX	%	Increase (Decrease)	%**
Other salaries and wages						
Payroll taxes						
Legal fees						
Telephone						
Occupancy						
Printing and publications						
Depreciation, depletion						
Other expenses (itemize):						
Amortization Expense						
Vehicle Expense						
Charitable Donations						
Insurance						
Consulting Fees						
Client Support						
Bad Debts						

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[REDACTED]

[REDACTED]

Total Revenue

* Denotes % of Total Revenue.
 ** Denotes % change from 20XX to 20XX.

Table 9
Statement of Financial Position
As of June 30

Assets	20XX	20XX	20XX
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
46 Savings and temporary cash investments	[REDACTED]	[REDACTED]	[REDACTED]
48 Pledges Receivable	[REDACTED]	[REDACTED]	[REDACTED]
50 Receivables from officers, directors, trustees and key employees	[REDACTED]	[REDACTED]	[REDACTED]
52 Inventories for sale or use	[REDACTED]	[REDACTED]	[REDACTED]
54 Investments - securities	[REDACTED]	[REDACTED]	[REDACTED]
56 Investments - other	[REDACTED]	[REDACTED]	[REDACTED]
58 Other assets	[REDACTED]	[REDACTED]	[REDACTED]
Liabilities			
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
61 Grants payable	[REDACTED]	[REDACTED]	[REDACTED]
63 Loans from officers, directors, trustees and key employees	[REDACTED]	[REDACTED]	[REDACTED]
65 Other liabilities	[REDACTED]	[REDACTED]	[REDACTED]
Net Assets or Fund Balances	[REDACTED]	[REDACTED]	[REDACTED]

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68 Temporarily restricted

70 Capital stock, trust principal or current funds

72 Retained earnings, endowment, accumulated income or other

9. Description of Liabilities

As of June 30, 20XX, the liability category is comprised of the following items:

<u>Item Description</u>	<u>Notes</u>	<u>Amount</u>
Client Funds in Escrow	(A)	
Reserve for Member Incentive Program	(B)	

a. Other Liabilities – Client Funds in Escrow

Client Funds in Escrow is reserved cash held in escrow for the payment of unsecured debt.

b. Other Liabilities – Reserve for Membership Incentive Program

Reserve for Member Incentives is comprised of a Membership Fulfillment Program and two Membership Incentives programs as follows:

- (1) Under the Membership Fulfillment Program, ORG will return a portion of the membership fees paid by any client member who completes the debt management program. To qualify, a client member must complete the program without making any late payments. ORG has reserved approximately \$ as of June 30, 20XX.
- (2) Under the first Membership Incentive Program, any client member is eligible to receive \$ for each person who becomes a new client member of ORG. As of June 30, 20XX, ORG has reserved approximately \$ for such program.
- (3) Under the second Membership Incentive Program, any client member who successfully refers eight as new client members is eligible to receive an even greater monetary reward. ORG has reserved approximately \$ as of June 30, 20XX.

D. Officers, Directors and Key Employees

1. Officers and Key Employees of ORG

The names and addresses of the officers and the key employees of ORG are listed below:

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Officers and Key Employees	Title
PRESIDENT	President, Director
Vice President	Vice-President/Director of Marketing
Secretary	Secretary/Treasurer
DOF	Director of Finance
DOTS	Director of Trust Services
DOBD	Director of Business Development
DOES	Director of Education Services

PRESIDENT is the founder, president and chairman of ORG. PRESIDENT graduated from the CO-11 with a Masters Degree in Business Administration and received his Bachelor of Science Degree in Accounting from CO-12. PRESIDENT is a certified public accountant, a certified credit counselor, and a financial expert on consumer credit, personal financial planning, and tax strategies, as well as specializing in both private consumer debt law and IRS practices and procedures.

PRESIDENT is currently a board member of the CO-13. He has been the past President and vice-president of the CO-8 (CO-8), a national trade association representing the consumer credit industry.

PRESIDENT also controls CO-10, CO-1, CO-9, CO-14, CO-15, and CO-16 – entities that are engaged in related party transaction with ORG.

Vice President is vice-president of ORG and is director of Marketing. Vice President has been employed by ORG for over a decade and is responsible for operations, marketing policies, hiring, and training of credit counselors. Vice President received a dual degree Finance and Marketing from CO-12.

In 20XX, Vice President was elected as the Vice President for the CO-8 (CO-8). Vice President's past experience includes working as a financial analyst for CO-17. He also performed tax, business, and financial planning for the owners of large private corporations. Immediately prior to joining ORG, he was a territory manager for CO-18.

Secretary is Secretary/Treasurer/Director of Finance. Secretary graduated from State State University in 19XX with a Bachelors of Science degree in accounting. As Director of Finance, Secretary was responsible for the preparation and analysis of financial statements, payroll and benefits, accounts receivable, accounts payable, state and federal tax and license compliance, systems design, improvement and analysis and all the financial reporting and responsibilities of several related companies.

Key employees include DOF who is the director of Finance. Prior to joining ORG, DOF was the CFO for CO-19 and CO-20 where he was responsible for the financial and administrative functions of the companies, as well as preparation of the business plan and financial projections. DOF has a Bachelor of Commerce Degree and a postgraduate accounting degree for the CO-21, Country. He is also a Certified Public Accountant and a Chartered Accountant.

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Another key employee is DOTS, the director of Trust Services. As the director of Trust Services, DOTS is responsible for the security, maintenance and upkeep of Trust Account. His department assures that all funds received and disbursed through the client's trust account are reconciled and that all payments made to creditors on the clients' behalf are accurate and timely. He has over 15 years of accounting and finance experience. Prior to joining ORG's team he was the Controller for a large City based corporation for 11 years. He received his Accounting Degree from the CO-22.

A third key employee is DOBD. As the director of Business Development, DOBD's responsibilities include developing strategic partnership alliances and orchestrating community outreach projects. DOBD serves as chairman of the local advisory committee of the Fannie Mae Mortgage Finance Program, which develops pilot programs aimed at increasing the minority participation in the mortgage finance industry. He also is the former chairman of the Southeast State Chapter of the State Bankers Association and is vice-president and treasurer of the CO-23. DOBD has a Masters in Business Administration and Bachelors of Arts degree in Psychology, CO-24, City, State.

A fourth key employee is DOES who is the director of Educational Services. DOES develops surveys and polls to collect data concerning consumers' financial needs and uses the survey results to develop promotional material and community outreach programs. Topics developed have included: Budgeting 101, Getting Out of Debt for Good, Credit Management - What You Need To Know, and Acquiring Smart Spending Habits. DOES promotional efforts have been published in the CO-25, CO-26, CO-27, CO-28, the CO-29, CO-30, CO-31, CO-32, CO-33 and other publications.

In addition, DOES writes and edits the ORG quarterly client newsletter, "NEWS-1." DOES' prior employment includes working as the promotions and public relations manager for a travel and event firm and counseling employees on 401K and IRA accounts at CO-35. DOES received her Bachelors of Science degree in Mass Communication from CO-34.

1. ORG's Board of Directors

The names and addresses of the individuals that comprised the board of directors of ORG for the year ended June 30, 20XX are as follows:

Board of Directors	Address
PRESIDENT, Chair	Address, City, State
DIR-5, Director	Address, City, State
[REDACTED]	[REDACTED]
DIR-7, Director	Address, City, State
DIR-8, Director	Address, City, State

DIR-5 is an alumna of CO-12 where she received her Bachelors of Arts degree in Politics and a Juris Doctor degree in Law. As a law student, DIR-5 participated in the Appellate Advocacy Program

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at CO-12, where she interviewed appellants, prepared briefs and represented clients throughout the Appeals process, including oral arguments before the State and the District of Country courts. Since then, DIR-5 has practiced law, specializing in general commercial litigation, real estate and corporate law.

DIR-7 is a graduate of the University of State, City, where he earned a Bachelors of Arts degree in Government & Politics and a Masters of Science degree in Technology Management and Entrepreneurship. DIR-7 is president and co-founder of CO-36 and has over 16 years experience providing strategic business consulting and technical project management services to technology-based businesses and the federal government. Recently, ORG selected CO-36 to manage the expansion of its national call center.

DIR-8 has a BBA and an MBA degree, both from the CO-11. Since 19XX, DIR-8 has been vice-president of CO-37, a company that runs nursing homes as well as chief executive officer of CO-38, a healthcare facility organization.

2. Duties and Responsibilities of the Board of Directors of ORG

Article III of the Bylaws stipulates that all corporate powers shall be exercised by or under the authority of the board of directors. In addition, the business and affairs of ORG shall be managed by the board of directors.

In performing his or her duties, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared by or presented by:

- one or more officers or employees of ORG whom the director reasonably believes to be reliable and competent in the matters presented;
- counsel, public accountants or other persons as to matters which a director reasonably believes to be within such persons professional or expert competence; or
- a committee of the Board of Directors upon which he or she does not serve, duly designated in accordance with a provision of the Articles of Incorporation or these Bylaws as to matters within its designated authority, which committee the director reasonable believes to merit confidence.

3. Minutes of the Board of Director Meetings

ORG provided the examining Revenue Agent general minutes of the board of director meetings for the period January 1, 20XX to December 31, 20XX. The matters discussed before the board of directors consisted primarily of the election of directors and officers.

4. Compensation of Officers, Directors and Key Employees

a. Compensation per Form 990

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The compensation paid to officers and key employees for the fiscal year ended June 30, 20XX is set forth below.

Employee	Title	Category	Compensation
PRESIDENT	President, Director	Officer	
Vice President	Vice-president	Officer	
Secretary	Secretary/Treasurer	Officer	
DOBD	Director of Business Development	Key Employee	
DOTS	Director of Trust Services	Key Employee	
DOES	Director of Education Services	Key Employee	
DIR-9	Credit Counselor Supervisor	Key Employee	

All officers and key employees are full-time employees of ORG. All outside directors provide their services on a voluntary basis and as such are not compensated for acting as a director. During fiscal year 20XX, each director received a \$ expense reimbursement to cover any expenses incurred in acting as a director.

b. Bonuses

Compensation is divided into a salary portion and a bonus portion. ORG provides that the bonus portion is set at a significant level so as to be a continual incentive to the employee to work hard and add value to ORG. The bonus portion is split into four quarterly amounts. Each quarter (January, April, July and October) the employee's performance for the prior quarter is reviewed. For the year ended December 31, 20XX, the salary and bonus paid to officers and key employees are as follows:

Employee	Title	Salary	Bonus
PRESIDENT	President, Director		
Vice President	Vice-president		
Secretary	Secretary/Treasurer		
DOBD	Director of Business Development		
DOTS	Director of Trust Services		
DOF	Director of Accounting		

c. Automobile Allowance

ORG gives the officers and key employees named below an automobile allowance (called "auto expense reimbursement allowance") to cover all use of private vehicles for company vehicles during calendar year 20XX.

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Employee	Auto Allowance
PRESIDENT	
Vice President	
Secretary	
DOBD	
DOTS	
DOF	

In response to IDR #ORG-017, ORG provides that senior employees receive a standard auto reimbursement amount each pay period. The amount was set at a limit estimated to equate to the employees average estimated bi-weekly business mileage incurred on behalf of ORG, multiplied by the standard mileage rate approved by the IRS. Employees were not required to provide substantiation for the actual business mileage incurred on behalf of the ORG.

E. The Activities of ORG

1. Operating as an Inbound Telemarketing Call Center

a. Inbound Telemarketing Call Center Described

During the fiscal year ended June 30, 20XX, ORG operated an inbound telemarketing call center staffed with credit counselors. An inbound telemarketing call originates with the respondents (callers). Such calls are made in response to a marketing offer directed via print, radio or other media sources. The respondents generally contact the call center by phone to ask for help.

b. Purpose for Which the Call Center is Operated

In furtherance of its exempt purpose, ORG operated the call center staffed with credit counselors to: (1) enroll callers in its debt management program; (2) provide financial counseling to individuals that are experiencing financial and debt-related difficulties; and (3) to disseminate self-help booklets to any caller interested in topics related to financial and debt management.

c. Call Center Team

In response to IDR ORG-002, ORG provided that, during calendar year 20XX, the number and title of call center employees were as follows:

Job Classification	Number of Employees Jan. 1, 20XX	Number of Employees Dec. 31, 20XX
Credit Counseling Manager		
Credit Counseling Supervisor		

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Credit Counselors		
Internet Specialists		

d. Accreditation of Counselors

During the year ended June 30, 20XX, ORG employed counselors, of which approximately percent were certified by a third party organization, as shown below.

Total	Number	Percentage
Certified Counselors		
Counselors Not Yet Required to be Certified		
Counselors in Certification Training		
Counselors Who Resigned Prior to Training		
Total		

e. Protocols for Providing Education, Counseling and Debt Management Services

Prior to the start of the examination, the examining Revenue Agent issued IDR ORG-002 which asked for, among other items, all versions of scripts and/or job aids utilized by or available to your staff for any client contact during FYE 20XX.

(1) FYE 20XX Scripts/Job Aids Materials Unavailable

In response to the IRS request, ORG stated that it no longer maintained the scripts/job aids employed by its credit counselors during the year under examination, because it believes such materials to be outdated. Instead, ORG provided the IRS with the most recent version (May 20XX) of protocol and training materials employed by its credit counselors in compliance with the IRS request.

(2) FYE 20XX Standard Protocol for Telephone Counseling and Qualifying Session

ORG's standard protocol for telephone counseling is broken down into the following components:

- (1) Greeting;
- (2) Qualify
- (3) Presentation;
- (4) Application Process; and
- (5) Approval

(i) Greeting Phase

During the Greeting phase, credit counselors are instructed to establish rapport with the caller and take the following actions:

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- Give the caller your name;
- Give the caller ORG's name and a brief description of its background and activities;
- Provide personal financial education;
- Use the term "credit counseling or debt management," not just "debt consolidation."
- Tell the caller ORG handles only unsecured debt;
- Tell the caller the service is for persons having difficulty with bills as opposed to only reducing interest rates;
- NO PRESSURE

ORG provides that this phase is used to determine whether the caller is interested in the debt management program or education.

(ii) Qualify Phase

During the Qualify phase, credit counselors direct their efforts towards determining whether the caller would benefit from the debt management program and what type of education is required. Listening to the caller is emphasized during this phase. The actions to be undertaken by the credit counselor include:

- Determining whether the caller has a financial need for the debt management program;
- Determining the type of education required;
- Computing the approximate amount of unsecured debt;
- Discussing the type of debts and the creditors involved;
- Determining the status of the debt payments;
- Determine if the debt management program is appropriate;
- LISTEN!

(iii) Presentation Phase (Preparation of Debt to Income Analysis)

During the Presentation phase, credit counselors determine whether the caller qualified for the debt management program. In furtherance of such goal, the counselor performs the following functions:

- Obtains the approximate amount of unsecured debt the caller owes;
- Obtains a description of the types of unsecured debt the calls owes;
- Determines the estimated payment and the total number of payments required to complete the debt management program;
- Reminds the caller that the payment amount is only an estimate, based on the information the caller provided;
- Describes the benefits of the debt management program;

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- Ensures that the caller understands the difference between the debt management program and a loan;
- Presents all options to liquidate the debt, including self assistance through education;
- Explain the disadvantages of the debt management program:
 - Inform the caller that all cards placed on the program will be closed;
 - Inform the caller that he or she cannot obtain new credit cards while on the program;
 - Explain the fees
- Asks the caller if he or she has any more questions;
- Remind them that education is important and remind them to visit our website; and
- NO PRESSURE! NO SELLING!

The estimated payment is determined by applying the specific percentage required by a creditor to the current debt balance. Although creditor requirements vary, ORG instructs its counselors to apply the following percentages to approximate the payment:

Creditor	Percentage
Most	
Most store and gas charge cards	
Most Unsecured Loans	
Medical bills and other "old" accounts	

At this point, ORG directs its credit counselors to ask if the caller has any questions. If the counselor feels the caller is satisfied with the information, comfortable with the program and program payment, and will truly benefit from the program, we can discuss the application process. As in the presentation, we will put NO PRESSURE on the caller to complete the application at this time, and give the caller every opportunity to hang-up, think about the information, and call back. If they are truly interested, they will stay on the line, or at worst, call back at a more convenient time.

(iv) Application Phase

During the Application phase, ORG provides the objective of counselors is to complete all the required fields (in the Software program) with information that is accurate as possible. In addition, counselors are expected to gauge the comfort level of the caller. If the caller is hesitant or uncomfortable, counselors are instructed to try to determine the nature of the discomfort and provide the information that the caller may need to move forward. If the caller remains hesitant, instruct him or her to call you back when ready to join the program. Do not sell.

(v) Approval Phase

During the Approval phase, the credit counselor performs the following functions:

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- Reviews the applicant's budget and list of creditors to insure that the caller has sufficient income to qualify for the program;
- Tells the caller that he or she qualifies for the program and will be receiving the Agreement and related information for their review and signature.
- Assure the caller that no action will be taken until the signed Agreement in receipt;
- Directs the applicant to the ORG web-site for additional information budgeting and related topics regarding the handling of financial situations. Applicants also are told that additional resources are made available only to members at no additional charge;
- Discloses creditor donations;
- Discloses program fees;
- Reviews enrollment procedures; and
- Instruct caller to keep up with payments to creditors until payments start with program.

2. Providing Educational Programs to the General Public

a. Educational Activities

Pursuant to its Form 990, ORG provides that it created numerous educational programs for individuals, community groups and students, ranging from the elementary to the collegiate level. ORG claims that these programs were designed to allow participants to achieve economic rehabilitation and to educate the young about the proper use of credit.

b. Dissemination of Educational Publications to the General Public

In furtherance of such goals, ORG distributed self-help booklets. ORG claims that such publications were designed to educate the general public in topics such as budgeting techniques and how credit works.

(1) Dissemination of Self-Help Booklets

During the examination, the IRS obtained a sample of booklets, educational in nature, from ORG. These booklets also are available at no cost to the walk-in public in the office lobby. The booklet titles are as follows:

- BK-1
- BK-2
- BK-3
- BK-4
- BK-5
- BK-6
- BK-7
- BK-8

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BK-9
BK-10
BK-11
BK-12
BK-13
BK-14
BK-15
BK-16
BK-17

ORG further provides that its self-help booklets were distributed to colleges and universities throughout the United States.

(2) Dissemination of Newsletters to Client Members

Pursuant to its educational program, ORG disseminated newsletters, educational in nature, to those callers who became client-members by participating in its debt management program. The ORG newsletter titled, "NEWS-1" is issued quarterly, and "NEWS-2" is mailed out monthly. NEWS-2 newsletter is published by a third party in City, State.

(3) Dissemination of Educational Matter via Web Site

The general public also can access the self-help booklets on ORG's web site free of charge.

(4) Dissemination of Educational Pamphlets to Organizations

ORG provides that it disseminated its educational materials to organization such hospitals, associations and credit unions. Examples of ORG's pamphlets are provided in Illustration's 3 – 6 below.

(5) Dissemination of Media Releases

ORG gives information regarding its services (or debt in general) to the North American Precis Syndicate (NAPS) who then distributes the information to over 10,000 newspapers, 1,000 TV stations and 6,500 radio stations throughout the United States. Then NAPS tracks the story to see how well it did and gives you the results.

Illustration 7 below sets forth below a January 20XX ORG media release. By April 5, 20XX, NAPS claimed that the release generated 608 newspapers articles in 24 different states with a readership of 35,656,560, based on the fact that when placements are reported 75 percent of the write-ins come from places from which there are no clippings in hand.

Illustration 8 graphs placements to date and circulation to date.

NAPS further provides that the release appeared in 17 of the top 50 markets, 23 of the top

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Market Appearance of "Don't Frown in Debt" Release	Markets	Placements
Top 50 Markets		
Top 100 Markets		
Top 300 Markets		

(6) Dissemination of Consumer Awareness Articles

ORG provides that it developed numerous consumer awareness articles that were published in national magazines. The published articles have titles such as ARTL-1, ARTL-2, ARTL-3 and ARTL-4.

c. Carrying On of Educational Workshops/Seminars

ORG contends that it conducted educational seminars for the general public at its place of business during fiscal year 20XX. For instance, ORG gave the examining Revenue Agent pamphlets listing the workshops that were conducted as follows:

Workshop Title	Date of Workshop	Place of Workshop
WS-1	September 19, 20XX	Place of Business
WS-2	October 17, 20XX	Place of Business
WS-3	November 14, 20XX	Place of Business
WS-1	December 12, 20XX	Place of Business
WS-2	January 10, 20XX	Place of Business
WS-3	February 13, 20XX	Place of Business
WS-1	March 13, 20XX	Place of Business
WS-2	April 10, 20XX	Place of Business
WS-1	May 15, 20XX	Place of Business
WS-3	June 19, 20XX	Place of Business

ORG claims that such workshops occurred monthly during fiscal year 20XX, however, documentation of the completed workshops (e.g., list of attendees, advertisement, etc.) was not maintained by ORG.

ORG states that it also created and participated in joint educational programs with CO-39, CO-12, CO-40, CO-41 and CO-42.

Illustration 3

ILLUSTRATION 3 DELETED

Illustration 4

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ILLUSTRATION 4 DELETED

Illustration 5

ILLUSTRATION 5 DELETED

Illustration 6

ILLUSTRATION 6 DELETED

Illustration 7

ILLUSTRATION 7 DELETED

Illustration 8

ILLUSTRATION 8 DELETED

F. Call Center Activities: Enrollment of Consumers in the Debt Management Program

One of the purposes for which the call center was operated is to enroll consumers in the debt management program of ORG.

1. Debt Management Program Described

Organizations that advertise credit counseling often arrange for consumers to pay debts through a debt management plan (DMP). In a DMP, you deposit money each month with a credit counseling organization. The organization uses these deposits to pay your credit card bills, student loans, medical bills, or other unsecured debts according to a payment schedule they've worked out with you and your creditors. Creditors may agree to lower interest rates or waive certain fees if you are repaying through a DMP.

2. How the Debt Management Program Works

Pursuant to the ORG Training Manual, the debt management program works as follows:

The debt management program is designed for individuals with unsecured debts that have become unmanageable. Secured debt such as mortgages and car loans will not be accepted on the program. The focus of the program is to consolidate these bills into one monthly payment, lower monthly payment requirements from the creditors, and negotiate lower interest rates. Generally, members will realize savings of %-% on a monthly basis through our system of negotiation with their creditors.

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Once in the program, a monthly payment is made to ORG. This payment includes a monthly membership fee that varies from \$-\$ (based on client's financial needs and amount of outstanding debt) and the specific payment amounts to each creditor. The client's payment should arrive by their assigned due date and will be disbursed to their creditors on the corresponding disbursement date. The client will continue to receive statements from their creditors reflecting our payments and are requested to send them in quarterly for review. It is the client's responsibility to open their bills and to notify us if there are any discrepancies at which time we will contact the creditor(s) for resolution. When the client is prepared to pay-off any or all of their accounts on the program, our staff will assist them in obtaining the correct amounts and disbursing the funds to their creditors by means of our office. Upon proper completion of the program the client will receive completion materials that include a letter of recommendation and a handbook about regaining credit written by PRESIDENT.

Illustration 2 below diagrams the flow of one ORG debt payment (including the monthly fee to ORG) from Client-Member to ORG before the specified payment date. After it takes out its monthly fee, ORG disburses the balance to each creditor (Creditor's #1, #2 & #3), in accordance with the program agreement. After the payment is received, each creditor issues a new billing statement, representing the subsequent billing period, to Client-Member. Each creditor also pays ORG a fee (e.g., percent of the debt payment) for collecting the debt on its behalf.

Creditor 4, on the other hand, has chosen not to agree to terms of the debt consolidation arrangement. Therefore, Client-Member must continue to pay his or her debt to Creditor #4, independent of the arrangement with Creditor's #1, #2 and #3. And Creditor 4 will continue to issue its monthly billing statement to Client-Member until the debt is extinguished.

Under the Membership Fulfillment Program, ORG will return a portion of the membership fees (represented by the dashed line) paid by Client-Member if he or she completes the debt management program. To qualify, Client-Member must complete the program without making any late debt consolidation payments.

Illustration 2

ILLUSTRATION 2 DELETED

3. Advantages of the Debt Management Program

According to ORG, the advantages of the program are as follows:

- Lower, more affordable monthly payment
- Reduced or even eliminated interest and penalty charges
- No more harassing phone calls from creditors

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- Improves Credit Rating

4. Program Service Expenditures

Table 10 below sets forth ORG's program service expenditures for the six year period ending June 30, 20XX, including the short year ended June 30, 19XX. For the six year period, expenses associated with the debt management program exceeded percent of the total amount expended for program services.

Table 10

Program Service Expenses per Form 990

Description	31-Dec 19XX	30-Jun 19XX	30-Jun 19XX	30-Jun 20XX	30-Jun 20XX	30-Jun 20XX
Debt Management Program (DMP)						
Education Program						
Total						

DMP as a % of Total Program Service Expense

G. Client-Member Fees

During the fiscal year ended June 30, 20XX, ORG did not charge any caller any fee for any phone call it received. Fees, however, were assessed once a caller became a client-member by enrolling in the debt management program.

1. Debt Management Fees

ORG charged its client-members an initial fee and a monthly fee. The initial fee is a one-time charge that is assessed at the enrollment date and can range between \$0 and \$. The monthly fee, however, is charged during the entire length the client-member remains with the debt management program and that too can range from \$0 to \$.

2. How the Fee is Set

According to ORG, both fees are dependent upon the following criteria:

- State fee limitations for those states that have mandated fee limits;
- CO-8 (CO-8) Code of Practice, which provides for an initial fee of \$0 to \$ and a monthly fee of \$0 to \$;
- Level of debt, e.g., a smaller fee charged on smaller debts;

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- Client-member's financial position and ability to pay the fee.

3. Membership Fulfillment Program

Under this program, ORG will return a portion of the membership fees paid by any client member who completes the debt management program. To qualify, a client member must complete the program without making any late payments.

4. Client-Member Terminations and Completions

In question #31 of IDR #ORG-002, the examining Revenue Agent asked ORG to specify, for each of its program activities during fiscal year 20XX, the average for each the following:

- (a) period of time an average client is estimated to take to complete each program;
- (b) percentage of clients who successfully complete the program;
- (c) percentage of clients who cancel or drop-out of the program within 6 months;
- (d) percentage of clients who cancel or drop-out of the program between 7- 12 months; and
- (e) percentage of clients who cancel or drop-out of the program between 13- 24 months.

In response to (a) above, ORG provided that, for 20XX, _____ client-members completed the debt management program. The average length these client-members were on the program was _____ years.

In response to (c) through (e) above, ORG provided the following statistics:

Description	Percentage
Percentage of clients who withdrew from the program within 6 months*	
Percentage of clients who withdrew from the program between 7-12 months*	
Percentage of clients who withdrew from the program between 13-23 months*	

* ORG provides that the withdrawals were due to completion or otherwise.

5. ORG's Relationship with CO-8

CO-8 is the credit counseling industry association. As such, it is a membership-based organization, of which ORG is a member. In addition, the current ORG president, Vice President, serves as CO-8's vice-president. Furthermore, PRESIDENT's biography on ORG's web site provides that he has been instrumental in the growth of the CO-8 and is the past President of the CO-8 and has held positions as the Vice President, and Chairman of the Client Retention Committee.

H. Call Center Activities: Provision of Financial Counseling & Education

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ORG contends that it educates consumers that contact its call center either by phone or by walk-in. It does not matter whether such consumers enroll in the debt management program. ORG firmly believes that it educates all consumers that talk to its credit counselors.

1. Electronic Case File Histories of Inbound Callers

a. Percent of Inbound Calls are not Documented

Vice President, the former credit counseling manager, stated that the Software computer software program in use during fiscal year 20XX documented only the information of consumers that qualified for its debt management program, viz., client-members and leads, where leads are consumers that qualified for but did not enroll in the debt management program. Based on his estimate, Vice President indicated that the Software program recorded less than percent of all inbound phone calls made during the fiscal year. As a result, ORG did not document more than percent of all inbound phone calls it received.

b. Remaining 10 Percent of Inbound Calls

ORG provided all of the electronic case file histories compiled by seven credit counselors. The seven counselors were selected based on their compensation. The case file comments discuss administrative procedures undertaken as opposed to educational or counseling provided.

2. IRS Third Party Contact of Former Credit Counselors

a. Questionnaire Submitted to Former Counselors

Former counselors were contacted by mail to ascertain the nature of and extent to which they educated and counseled callers. The former counselors wrote that the objective of the job was to enroll consumers in the debt management program.

b. Phone Interview of Former Counselors

Former counselors were contacted by phone to ascertain the nature of and extent to which they educated and counseled callers. The former counselors stated unanimously that ORG's objective was to enroll consumers in the debt management program. Moreover, if education were provided to consumers, it was due to the personal and professional experience of the counselor, as opposed to any training provided by ORG.

I. Marketing Strategy

ORG conducts its business in states. As an inbound telemarketing call center, ORG does not permit its credit counselors to make outbound phone solicitations. Credit counselors may, however, return a phone call or even contact a caller who asked the counselor to contact him or her at a later time or at a later date. Therefore, the success of its debt management program resides on the effectiveness and scale of its advertising campaigns.

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1. Public Awareness Campaign

With respect to its overall marketing strategy, ORG provides:

...we can easily describe our overall strategy for utilizing various media outlets to further our main purpose of educating the public with regards to the assistance that is available for those experiencing financial difficulties.

During FYE 20XX, a significant portion of our public awareness addressed the negative effects of debt on the consumer. ORG created separate 30 second television announcements for each of several issues including depression, fear, anxiety, hopelessness and how debt hurts everyone in a family. Copies of the foregoing were previously provided.

The aim of the messages was to show that being in financial distress created negative financial and emotional consequences. It is our hope that these announcements were equally informative to consumers who are in trouble with their debts as it is to consumers who are not. In other words, the announcements were designed as a deterrent against getting into trouble with debt and a message of encouragement for those in trouble to seek assistance.

These messages also addressed the negative effect of debt on the well-being of the consumer and his/her family, which is often not realized. Public awareness via radio and television is accomplished by purchasing low-cost remnant ad space in radio and television, with an air time between 30-60 seconds. The main focus of ORG's Internet site has always been to provide education to the consumer with free access to all of our educational services and products. ORG's billboard advertisements reflect a "Debt" theme to attract consumers in true financial need.

The main goal of our public awareness efforts is to attract the most debtors with poor credit management habits and attempt to modify their behavior with education and counseling.

2. Formal Advertising Plan, Market Research & Analysis of Competition

ORG does not have a formalized written marketing and/or public awareness plan. However, a related entity, CO-1 d/b/a CO-1 (CO-1) assisted in producing and placing all contracted public awareness messages for ORG. Remuneration to CO-1 for fiscal year 20XX was \$.

ORG does not conduct formal market research, directly or indirectly, and does not conduct formal analysis of competition, directly or indirectly.

3. Measuring the Effectiveness of the Public Awareness Campaign

In fiscal year 20XX, ORG's phone system was not capable of providing detailed call reports by media source. As a result, public awareness was tracked by market based on the consumer's ZIP

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code. Using this tracking method, however, permits ORG to record the zip codes of only the callers that qualify for its debt management program.

For printed material, the effectiveness of public awareness was tracked by publication. For instance, when consumers called, credit counselors would inquire about the location the ORG message was heard or seen. Like the prior method, ORG records the publication source of only the callers that qualify for its debt management program.

ORG states that it no longer possesses any old reports for fiscal year 20XX. However, based on a current blank Media Analysis template, the following measurements were tracked for each market and for each type of media:

Total cost

of applications # of clients

Cost/application .Cost/client

Ratio of clients to application

The effectiveness of ORG's public awareness activities is determined by the volume of counseling activity generated.

4. Determination of Target Markets

ORG chooses its markets based primarily on where it is able to advertise at a cost that meets our budget sensitive financial criterion for that medium.

5. Shape of the Marketing Message

When asked how it shaped its message, ORG responded:

ORG tailors its public awareness campaigns to capture the attention of debtors who are having financial difficulties. Our messages are designed to make consumers aware of the availability of our services as well as make people aware of the dangers of getting in trouble with debt. We have several varying messages; however, we air messages a minimum of 6,000 times per month that makes no mention of a debt management program. It only informs the public about free educational resources available from our organization.

6. Use of Various Marketing Mediums

ORG provides that it selects the most appropriate public awareness medium taking into account the geographic areas and mix of mediums. For fiscal year 20XX, ORG used the following mediums:

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General Ledger Acct No	Description of Medium	Expense
6000	Yellow Pages	
6005	Billboards	
6010	Radio	
6015	TV	
6016	Internet	
6020	Advertising - Other	

7. Examples of Advertisements Found in Various Publications

In the Information Documents Requests listed below, the examining Revenue agent obtained from ORG copies of advertisements (and the invoices associated with such advertisements) it placed in various publications:

- IDR #ORG-037, CO-43
- IDR #ORG-038, CO-44 CO-45
- IDR #ORG-041, CO-44
- IDR #ORG-049, CO-46s

(e) Ad in CO-43 - CO-47

AD DELETED

Publication: CO-47
Issue: September 1, 20XX
Circulation: 4,050,000
Size of Ad: ½ page 4 Color - Vertical
Total Due: \$
Placement Service: CO-1
Client: ORG
Deadline: May 29, 20XX

(f) Ad in CO-44 - CO-48

AD DELETED

Publication: CO-48
Issue: February 20XX
Circulation: 3,500,000
Size of Ad: ½ page 4 Color - Vertical
Total Due: \$
Placement Service: CO-1
Client: ORG

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Deadline: November 12, 20XX

(g) Ad in CO-44 – CO-33

AD DELETED

Publication: CO-33
Issue: December 18, 20XX
Circulation: 4,636,364
Size of Ad: ½ page 4 Color – Vertical
Total Due: \$
Placement Service: CO-1
Client: ORG
Deadline: September 15, 20XX

(h) Ad in CO-46s – CO-49

AD DELETED

Publication: CO-49
Issue: August 1, 20XX
September 1, 20XX
October 1, 20XX
January 1, 20XX
February 1, 20XX
April 1, 20XX
May 1, 20XX
June 1, 20XX
Circulation:
Size of Ad:
Total Due:
Placement Service: CO-1
Client: ORG
Deadline:

J. Credit Counselors

1. Duties and Responsibilities

According to the job description ORG provided to the examining Revenue Agent, the primary responsibility of credit counselors is to receive inbound phone calls from across the country. The description also stated that the calls are made by consumers in various stages of debt payment distress and that credit counselors help such consumers improve the quality of their lives through debt consolidation and financial education.

The job also is described as follows:

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- Customer service minded person who enjoys talking over the phone, and helping them by providing sound financial advice and counseling;
- Receiving approximately 10-15 incoming call per day;
- Gathering information about customers financial issues;
- Determining debt obligations by interviewing clients;
- Examining bills and payment schedules;
- Determining financial resources by examining income, assets and expenses;
- Developing a financial plan for the client where necessary by reducing high-interest debt;
- Establishing priorities and a living expense budget while developing a Debt Management Program for the client;
- Develops agreements with creditors on the client's behalf for lower monthly payments; and
- Providing community outreach and education regarding wise use of credit and other credit related topics.

2. Candidates for the Credit Counselor Position

a. Applicants

ORG's employment advertisements do not specifically target credit counselors, counselors employed in other fields, or social workers. ORG provides that it looks for a variety of characteristics without regard for any previous "credit counseling" experience. For instance, ORG states that it searches for qualified applicants who have college degrees and significant business experience in related fields, and who can empathize with a client's financial situation. ORG further states that it looks for counselors with a stable work history, demeanor, good communication and listening skills.

b. Community Volunteers

ORG provides that it does not recruit community volunteers to perform counseling services as it believe that its core competency is highly specialized.

3. Initial Training

a. Course Title, Objective and Curriculum

The course title of the initial training class is "New Counselor Orientation and Training." ORG provides that the goal of its training program is to ensure that counselors are proficient in their ability to assist clients in resolving their debt related issues through counseling and education. ORG also states that course curriculum consists of an introduction and orientation to ORG and protocols for providing education, counseling, and debt management services to clients.

b. Content of the Training Manual

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The text new counselors are given during the initial training is called "ORG Training Manual." The Manual's table of content, which is provided below, summarizes the topics of learning:

Table of Contents

Chapter One: Introduction to Credit Counseling

- a. Introduction
- b. Industry Based Training:
 - Credit Cards and What you Need to Know – CBT
 - BK-9 – CBT

Chapter Two: ORG, Inc.

- Quality Statement
- History of the Company
- Organizational Staff: Brief Bio's
- Client/Creditor/Community Relations
- Affiliated Companies
- You Can Make A Difference

Chapter Three: Products and Services

- Key Words
- How Our Program Works
- Advantages of the Program
- Flow Chart: Life Cycle of an Account
- Steps to Enroll
- Membership Agreement and Sample
- Sample Client Letters (Welcome and Initial Payment)
- Payment Methods
- Auto-pay Advantages/Sample Acquisition
- A Guide to Due Dates and Disbursals
- Gold Membership Rewards/Brochure
- Partner Companies and Services: Rush Card, Home Savers, Legal Club, Mortgage Referrals, and more
- Soldiers and Sailors Benefit
- Free Education

Chapter Four: Effective Communication and Telephone Etiquette

- Effective Communication
- Telephone Etiquette
- Customer Service Basics
- Common Courtesy
- Telephone Tips
- Handling an Irate Client
- Use of the Hold Button
- Focus on Service
- Avoiding Negative Statements

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- Ways to Say Thank You
- Rules to Customer Service
- Call Model

Chapter Five: Statement Reconciliation

- Statement Examples
- Reading a Statement: What to Look for
- Updating Statements
- Statement Problems
- Cheat Sheet for Call-On Statements

Chapter Six: Systems

- Phone Systems
- Software
- Microsoft Outlook
- Right Fax
- Digital Documents
- Imaging 101 Scanning Software

Chapter Seven: Forms and Procedures

- Proposals: Accepted and Declined
- Digital EDI Proposal Request
- Program Payment Requests
- Increase Payment Requests
- Cashback Request
- Refund Requests
- Fairshare
- Adding A Creditor
- Removing A Creditor
- Digital Check Status Request
- RPS Payment Inquiry Form
- Referrals
- Digital Creditor Changes
- Digital Fund Transfers
- Payoffs
- Letter Request Form (Sample Letters)
- Reinstatements/Temporary Closures
- Lower Payment Request/Budget Form
- Post cards/Removing Clients From Mailing List
- Changing Account Numbers
- Legal Procedures
- Welcoming Clients/Proofing Files
- Autopay Cancellation/Revision Procedures

Chapter Eight: Stress management –CBT

- General Info on Stress
- Top 20 Stressors in Life

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- Good and Bad Stress
- Stress and Your Immune System
- Stress Assessment
- Coping Behaviors Checklist
- Chapter Nine: Job Aides
 - Welcoming Job Aide
 - Retention Job Aide
 - Creditor Concessions
 - Company Contact Info (Extensions and Fax Numbers)
 - Affiliated Co's Chart
 - FAQ – Credit Bureau
 - Time Zone Chart
- Frequently Asked Questions
- Glossary

4. Initial Interview Training – The Job Script

The job script new counselors are taught is as follows:

Initial Interview Training

GREETING:

Credit counseling, this is _____ . May I help you?

What zip code are you calling from? You are in (city)_____ in (state)_____

Let me tell you what we do and see if it's what you are looking for, ok?

The name of our service is ORG...

We're a federally approved tax-exempt non-profit organization. Our main goal is to provide personal financial education and tools that can help you get out of debt..

We are Run by accountants and financial professionals. And, we're set up to help people who are over extended on things like:

- Credit cards
- Medical bills
- Department store cards
- Or

...if you have any kind of personal loan that was not made with collateral. In other words we can't help with car payments, house payments, current light bills or current phone bills. The reason for that is they can be taken away or turned off. We can however help with old bills.

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Now, is that the situation that you're in? (Listen!)

If you qualify, can help get you BETTER payments.

QUALIFY:

What kind of bills are you dealing with?

Do you have any idea how much do you owe?

Tell me, what's going on with the payments? Are you current or are you running a little behind?

(If current)

What kind of interest rates do you have? Are they high or low?

Do you ever pay more than the minimum due?

Are you still charging more than you are paying each month?

Are your balances going down each month?

Are your cards maxed out or close to being maxed out?

(If current)

Based my experience, if you're on time and making only the minimum payments each month... it would probably take you around years to pay that kind of debt off.

Look, you're making payments...does the amount you owe go down very much each month? (Wait for a reply and give the person a chance to talk about how they feel about their situation) . .

(If behind)

When was the last time you made a payment?

Are they calling or bothering you, very much?

(If yes) Besides helping to get you out of debt, one of the other advantages of this program is helping to get those calls stopped.

(If behind)

Based my experience EVEN IF you were on time and making minimum payments each month... it would probably take you around years to pay that kind of debt off. The reason for that is once you get behind all your really doing is paying interest, late fees and penalties.

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...does the amount you owe go down AT ALL each month? (wait for a reply and give the person a chance to talk about how they feel about their situation). (If the person does not indicate any concern over their situation, question them further to make sure that you both truly understand their situation. If at this Point a DMP does not seem appropriate, inform them that we have Financial Resource specialists that can help to determine what type of educational assistance may benefit them and transfer the call after making a brief introduction)

EXPLAIN: (After hearing an acknowledgement of the serious nature of their situation)

What we can do is combine all of those debts into one monthly payment. We can work with your creditors to get you an interest rate of around 8 to 10% (If accurate based on creditors mentioned). (Stop the late fees and penalties, including most over the limit fees) so that the majority of your payment goes towards paying off what you owe...

If you want, I can figure out what your payment should be. Do you have an idea of who you owe and approximately how much you owe each one? I don't need any of the account numbers at this time. (Go to Software "Creditor Info" tab.. .make sure there is a lead number)

Altogether you owe around \$_____ I can get you a payment of approximately \$_____ with an interest rate generally averaging around 8 to 10 %...and it should only take you about 3.5 to 4 years to pay it off.

Would that help you?

I need to tell you there are disadvantages to this... You'll have to be willing to give up the credit cards that you put on the program. (Your creditors will not allow you to continue to charge on these accounts while you are paying them off at the reduced interest rates.) Also, you will not be able to get any new credit cards until you finish the program. Is that ok?

Also, you need to remember that this is not a "free ride". Even though this will save you money, you are still paying some interest to your creditors and there are some fees associated with our service and I'll explain it all to you in advance... OK?

Let me explain...

Because we are a non-profit company, your credit card companies allow us to arrange for our clients to receive lower interest rates, (and stop the late fees and penalties) so they can pay their bills off faster.

All of your bills will be ORG into one payment... Each month you send your payment to a trust account, and then we pay each of your creditors automatically. If at any time you have extra money send it to us. It goes directly to the principal and you will be out of debt even faster.

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In addition, if you've been behind, after you're with us for 90 days, your creditors will generally re-age your accounts... Bringing them back up to current status. Besides getting you out of debt we also help you improve your credit rating and provide a variety of free educational resources which are available to all clients and non-clients alike.

The bottom line is, this is the least expensive way to payoff this kind of debt and without hurting your credit rating...

Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions? Do you have any questions?

(If the person does not indicate an interest in Debt Management, DO NOT SELL), inform them that we have Financial Resource specialists that can help to determine what type of educational assistance may benefit them and transfer the call after making a brief introduction).

(Go to application **only** if ready)

Application:

The next step is to do an application to see if J can get you approved for the service? Then I will mail you a proposal for your review.. after reading it over, you can decide if this will work for you... Do you have 10 or 15 minutes to spend on the phone?

(Go to Software)

...How did you hear about us?

(After application)

What I'm going to do now is have your application reviewed for the program... but first

(After application)

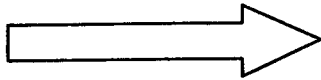
(Name)_____grab a pen and piece of paper and take my name and number... I need you to call me back in about one hour to see if you have been approved.

(Slowly)

1. My name is _____ my phone number is _____
2. The name of the company is ORG
3. We are a non-profit agency
4. Run by CPAs
5. If you need any additional information on our company you can check out our web-site at website also you can access all of our free financial educational resources.
6. Also you can get our company history from the 888... All you have to do is call their national number

Now, need you to call me back in about one hour, ok?

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**See change regarding initial fee.
Replace and destroy old page**

(DON't forget to say, "You're welcome")

Approval:

_____, I have good news. I was able to get you approved for some help...

You owe around \$_____. Correct? Your payment on this will be about \$_____. Do you feel sure that you can afford this?

Now let me explain how we get paid...the majority of our revenue comes from donations that your creditors make in order to support what we do. Also we receive \$_____ out of each payment. That helps to cover our costs for servicing your account each month. It's not extra this is built into each payment of \$_____ you'll make each month. Also, it costs \$_____ (\$0 to \$) to establish an account with us...and that is due whenever you are ready to begin.

(Only if asked) This is far less than you would have been paying in interest [and late fees] understood?

(NOT VALID IN STATE) Also, as a bonus when you finish the program we will send you \$. In order to receive this you must make all of your payments on time and payoff all of the bills through our program...Understand? You can take the money and celebrate!

One more thing I have to cover with you. There are a number of ways you can make your monthly payment. The easiest way is to have it automatically taken out of your checking account each month. Otherwise, you'd need to send in a money order, bank check, or pay with Western Union each month or check by phone which can get expensive. Obviously the best way is to do it by autopsy.

Do you have a checking account?

(If Yes) Would you like me to send you the forms?

(If Yes) All you need to do is attach a voided check, check the box to pay the initial fee automatically, check the box to pay monthly, and sign the form.

(If no) No problem...

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I will send out your approval package today. It will include a list of instructions of the things you need to send back in order get started. It will tell you to send

Copies or originals of all of the bills that you want help with.

A Check for \$ _____

Read and sign the membership agreement. What this does is give us the things you need to send back in order get started. It will tell you to send

- Copies or originals of all of the bills that you want help with.
- A Check for \$ _____
- Read and sign the membership agreement. What this does is give us permission to contact your creditors in order to get you the lower interest and payments. It does not create any type of obligations on your part. You may drop out of the program any time you want.
- **(Autopay)** don't forget the Autopay form with voided check.
- **(State only):** look over the budget analysis and sign it.
- A photo-copy of a recent pay-stub.
- A photo copy of your driving license

The only thing I ask is that you send all of this information back by priority mail...it only costs \$. This will help us identify your package as a new client in our mail room and allow us to process it much faster.

Do you have any questions?

Ok, after you receive our proposal read everything over and call me if you have any questions. If not, please call me before you send the envelope and we'll make sure that everything is there so that the process of getting you started and getting you out of debt won't be held up.

DO YOU HAVE ANY QUESTIONS?

5. Description of the Training Process

In response to the examining Revenue Agent's inquiry regarding the type of training new counselors received, ORG provided the following statement:

The training for newly hired counselors is conducted internally. There is an intensive one-week training session that is given to all new counselors prior to interacting with clients. Due to our excellent counselor retention rate, counselors are usually hired and trained one or two at a time. As a result the training conducted by our credit counseling manager or supervisor is extremely personalized to the individual training needs of our new counselor. Counselors are provided with a training manual which covers information on the company, company policies, protocol for counseling and information regarding the services ORG offers. A copy of the protocol for counseling has been provided previously to the Service. Additionally, new counselors are also trained on the

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use of our computers and our computer systems. Counselors receive extensive training on the workings of all departments within the organization in order to provide them with the best possible perspective of the services provided to clients. As part of the training process new counselors sit side by side with the trainer and listen in on the phone calls and counseling sessions of experienced counselors. After the initial training and once ready to work on their own, the new counselor is monitored constantly and on a daily basis for a significant period of time and retrained in areas where they have a weakness. New counselors also attend the same on-going training as our more experienced counselors.

6. Evaluation of New Counselors During the Training Process

ORG claims that counselors in training are evaluated at various stages throughout the training process by undergoing constant monitoring. Counseling sessions are tape recorded and played back to the counselor by the credit counseling manager who in turn provides constructive verbal feedback on any areas that need improvement. In addition, as stated above, training is conducted on a one to one basis thus ensuring that counselors receive individualized feedback allowing the counseling manager to monitor their progress. Monitoring continues for months after initially trained.

7. Effectiveness of the Training Program

The effectiveness of the training program is evaluated by auditory monitoring of counselors on a regular basis by the credit counseling manager. The credit counseling manager completes a "Telephone Counseling Screening Report" during the monitoring process. This is subsequently discussed with the counselor and then the report is discarded.

8. Ongoing Training

According to ORG, the counseling department meets on a weekly basis. Counselors meet to discuss issues within the company, new laws, updated and new procedures, and any other issues pertinent to the industry or their profession. Feedback is provided by the credit counseling manager regarding counselor performance to rectify any deficiencies a counselor may have.

9. Compensation

a. May 11, 20XX Memo to Counseling Staff re: Pay System

The memo provides that counselor compensation is not based on the outcome of each individual counseling session but rather on recommending debt management to those individuals who may benefit from this program. Under this policy, counselor compensation is determined as follows:

- Counselors will be paid a flat rate of \$ per client making a DMP payment, provided at least 25 clients have made a payment during the corresponding pay period.
- The flat rate falls to \$ per client if the total number of clients is under 25.

b. Payment of Bonus

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Performance bonuses are paid at each of the following breakpoints:

Total Payments	Bonus Amount
30	
40	
50	
60	
70	

c. Draw

Because counselors are paid on a commission only basis, new counselors are paid a draw, which represents a loan that the counselor pays back, as follows:

...because of the delay in a new counselor reaching full productivity due to an extensive initial training and a normal learning curve, it is our practice to insure that new counselors earn at least \$ per week. As a result, small advances are commonly given to new counselors, advanced against their projected future productivity.

K. Related Parties and Related Party Transactions

1. Ownership Interests Held By Founder (See Exhibit 1)

PRESIDENT, the founder, president and chairman of ORG, has an ownership interest in the following entities that provide services to ORG:

Entity Name	Ownership Interest
CO-1,	Sole
CO-9	Sole
CO-16, dba CO-16	Principal
CO-10	Sole
CO-14	Sole
CO-15	Sole

2. Ownership Interests Held By Directors

DIR-7, director, is the president and co-founder of CO-36, Inc. The web site of CO-36 provides that it is a management and technology consulting firm that helps organizations develop and implement marketing and growth strategies, improve operations and capitalize on technology.

3. Related Party Transactions

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a. **Back Office Processing Services** (See Exhibit 2)

(1) **Background**

Sometime on or before January 9, 19XX, ORG decided to outsource its back office processing services. Pursuant to the January 9, 19XX minute of meeting of the committee of independent directors of the board of directors ("Committee"), the benefits of outsourcing include the following:

- Reduction in payroll;
- Reduction in office space under lease;
- Reduction in general overhead expenses; and
- Greater emphasis on client and community education;

No report quantifying such financial benefits was provided to the examining Revenue Agent.

(2) **Agreement with CO-10**

On January 9, 19XX, ORG signed an agreement with CO-50 (CO-50) to outsource its back end processing services to CO-50.

(3) **Certain Terms Contained in the Agreement**

The term of the agreement is from January 1, 19XX to December 31, 20XX and is automatically renewable for an additional term of 3 years, unless either party provides written notice to the contrary at least 180 days prior to the end of the then current term.

The agreement may be terminated under the following circumstances:

- Expiration of agreement;
- Revocation of regulatory authority for ORG to conduct any debt consolidation activities;
- Failure of ORG to make payments for services described herein.

The fee for the services is a monthly charge based on the number of active clients of ORG for such month as provided below:

Number of Active Clients	Monthly Fee per Client
999 or fewer	
1,000 – 2,999	
3,000 – 4,999	
5,000 or more	

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An "active client" are those listed in active status on the database at the end of any month regardless of whether they have made a payment that month.

The agreement requires ORG to defend, indemnify and hold harmless CO-50 from and against any and all claims, demands, suits, losses, costs, expenses, obligations, liabilities and damages (including attorneys' and paralegals' fees and costs) incurred or sustained by CO-50 by reason of ORG's inability to maintain their regulatory authority or in connection with any breach of ORG's obligations.

Additional rights of CO-50 include:

- Upon ORG's termination, CO-50 has the right to compete for all of ORG's clients either on behalf of CO-50 or on behalf of another non-profit corporation engaged in credit counseling.
- Any software designed, licensed, purchased and used by CO-50 is and will remain the property of CO-50.
- Upon termination of the agreement, ORG shall return the originals and all copies of all information, data and materials provided by CO-50, regardless of whether such information, data or materials constitute confidential information, to CO-50.

(4) Disclosure of Agreement with CO-51

The agreement also discloses that CO-50 provides similar services to CO-51, an IRC 501(c)(3) credit counseling organization and that for administrative ease CO-50 is authorized to:

- (1) process billings and applications for contributions from credit grantors attributable to the active clients of CO-51 in the name of ORG;
- (2) deposit all collections from credit grantors to an account in the name of ORG; and
- (3) make such distributions to CO-51 as may be required in accordance with applicable agreements between ORG and CO-51.

(i) Services to be Provided by CO-10

A. Data Entry

- a. Entry of client information (i.e., name, address, home and work phone numbers, social security numbers, scheduled payments and demographic and referral information) provided by ORG;
- b. Entry of credit information provided by ORG, including a screening a creditors to make certain that the correct amounts are being paid;
- c. Sending program orientation packets to all clients and calling all clients initially set up by assigned customer service personnel;

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- d. Follow up with clients who need to provide additional information;
- e. Revising scheduled payments for clients of ORG in consultation with clients' creditors;
- f. Sending out proposal letters to creditors on behalf of clients of ORG;
- g. Monitoring the proposal acceptance process; and
- h. Maintaining the database, which tracks all client deposits and disbursements.

B. Customer Service

- Responding to creditors' inquiries regarding client accounts;
- Responding to clients' inquiries regarding their accounts;
- Addressing clients' concerns with creditors;
- Researching questions posed by clients and creditors, when necessary; and
- Confirming establishment of payment plans when requested by potential lenders.

C. Computer Support

- Maintaining a database program which retains all client and payment information and makes the information easily accessible (provided that ORG shall perform all trust account reconciliation and check disbursement payment inputting); and
- Revising and modifying the data system, as needed.

b. Software Leases

On January 1, 19XX ORG entered into a software license agreement with CO-9 (CO-9). The effective date of the agreement is October 31, 19XX. The term of the agreement is 3 years. The term is automatically renewable for successive 3 year periods, unless either party provides written notice to the other party of intent not to renew at least 30 days but not greater than 120 days prior to the end of the then existing term.

CO-9 developed and owns two computer software programs. The programs were developed for use by credit counseling organizations. The first program (Counselor Program) tracks productivity of counselors, calculates counselor performance and margins. It also is a database of leads, sources of leads and client information. The second program (Trust Program) is a database in which client payments and disbursements and member activity are maintained.

The total monthly license fee is \$.

c. Advertising

On January 1, 19XX ORG entered into an advertising services agreement with CO-1. The effective date of the agreement is January 1, 19XX. The term of the agreement is 3 years. The term is automatically renewable for successive 3 year periods, unless either party provides written notice to

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the other party of intent not to renew at least 30 days but not greater than 120 days prior to the end of the then existing term.

Under the terms of the agreement, CO-1 agreed to produce and place advertising for ORG's Debt Management Program. For instance, CO-1 would meet with ORG regarding where ORG should be advertising and would place the ads. In addition, CO-1 would supervise script and production of the ads.

ORG shall pay a monthly fee equal to (a) the total amount expended by ORG during the prior fiscal year for advertising; (b) multiplied by a factor of 15%; and (c) divided by 12 months. Based on the ratio, the appraiser, CO-52, values the services at \$ per month.

According to the previous agreement between ORG and CO-1 dated 12-20-19XX, CO-1 is to produce and place advertising for ORG @\$/mo.

d. Office Furniture, Fixtures and Computer Equipment

On January 1, 19XX, ORG entered into a personal property lease with CO-14 The effective date of the agreement is January 1, 19XX. The term of the agreement is 5 years. The term is automatically renewable for successive 3 year periods, unless either party provides written notice to the other party of intent not to renew at least 30 days but not greater than 120 days prior to the end of the then existing term.

Under the terms of the agreement, ORG agreed to lease all of its office furniture, fixtures and computer equipment from HSD. In addition, ORG acknowledged that, as a result of material additions to equipment, it underpaid its monthly rent from July 1, 19XX to December 1, 19XX as a rate of \$ per month (or \$ in total).

Pursuant to the CO-52 appraiser's report, the total monthly lease payment should be \$ per month.

e. Office Space

In December 19XX, ORG entered into an office space lease agreement with CO-15 The term of the agreement is 66 months. The term is automatically renewable for 3 additional terms of 5 year periods, unless either party provides written notice to the other party of intent not to renew at least 30 days but not greater than 120 days prior to the end of the then existing term.

ORG agreed to pay \$ per year or \$ per month.

The lease was amended on June 1, 20XX to increase ORG's annual rent to \$ or \$ per month. In addition to the base rent, the appraiser, CO-52, determined that an estimated charge of \$ per square foot would be assessed to cover costs to the common areas and operating expenses.

f. Benefits Program

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On September 1, 19XX, ORG entered into an Enhancement Program agreement with CO-53 (CO-53). The initial term of the agreement is 5 years. The term is automatically renewable for 2 successive renewal terms, unless either party provides proper notice of non-renewal to the other party not less than 120 days prior to the end of the then existing term.

Under the agreement, CO-53 agreed to provide a package of benefits and related brochures to ORG, which it then offered its client-members.

One of the primary benefits offered through the membership package is a \$ Accidental Death and Dismemberment (AD&D) policy. In addition to the AD&D policy, the membership package includes a variety of helpful items and discount benefits. According to the agreement, besides the AD&D policy, the membership package includes, but is not limited to:

- | | |
|---|---|
| <input type="checkbox"/> Travel and entertainment discounts | <input type="checkbox"/> Discount long distance service |
| <input type="checkbox"/> Movie and theme park discounts | <input type="checkbox"/> Discount contact lenses |
| <input type="checkbox"/> Travel rewards | <input type="checkbox"/> Budget analysis form |
| <input type="checkbox"/> Car rental discounts | <input type="checkbox"/> Grocery coupons |
| <input type="checkbox"/> Key Ring registration | <input type="checkbox"/> Mail order pharmacy |
| <input type="checkbox"/> Asset organizer | <input type="checkbox"/> Household inventory record |
| <input type="checkbox"/> Custom trip planning | <input type="checkbox"/> Vision care |
| <input type="checkbox"/> Discount flowers and gifts | <input type="checkbox"/> Instant coupon |
| <input type="checkbox"/> Medical ill card | <input type="checkbox"/> Money for college |
| <input type="checkbox"/> Auto emergency log | |

The fee charged to client-members is \$ per new client-member set-up and \$ per month for the cost of the Enhancement Program.

g. CO-36

For the years ended June 30, 20XX, ORG has paid CO-36 approximately \$. In a subsequent fiscal year, however, ORG selected CO-36 to manage the expansion of its national call center.

h. CO-51

In selecting CO-50 to provide back office administrative support, the Committee Independent Directors of the Board of Directors cited CO-50's contract with CO-51, presumably as proof of CO-50's competence to provide such services to ORG. However, neither the Minutes of Meeting of the Committee Independent Directors of the Board of Directors nor the Minutes of Meeting of the Board of Directors disclosed several facts:

- CO-51 was incorporated in the State of State on January 7, 19XX.

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- CO-51's initial application for exemption submission was denied in October 19XX.
- CO-51's second application for exemption was received by the IRS on January 18, 20XX.
- For the year ended June 19XX, CO-51 reported \$ revenues.
- For the year ended June 19XX, CO-51 reported \$ in revenues.
- For the 6 month period ended December 19XX, CO-51 reported \$ in revenues.
- PRESIDENT is a Director of CO-51.

III. APPLICABLE LAW

1. Exemption From Federal Income Tax

Internal Revenue Code section (IRC) 501(a) exempts from Federal income tax the income of organizations described in IRC 501(c).

2. Requirements Applicable to Organizations Described Under IRC 501(c)(3)

Under IRC 501(c)(3), an organization qualifying for exemption from federal income tax, pursuant to IRC 501(a), must meet the following requirements:

- it must be organized and operated exclusively for one or more religious, charitable, scientific, testing for public safety, literary or educational purpose, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals;
- its net earnings may not inure to the benefit of any private shareholder or individual;
- no substantial part of its activities may be the conduct of propaganda or otherwise attempting to influence legislation; or
- it may not participate in, or intervene in any political campaign on behalf of or in opposition to a candidate for public office.

3. Two Prong Test for Determining and Maintaining Exemption Status Under IRC 501(c)(3)

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

a. Organization Test

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

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- limit the purposes of such organization to one or more exempt purposes; and
- do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

b. Operational Test

TR 1.501(c)(3)-1(c)(1) provides that an organization must be engaged primarily in activities that accomplish one or more exempt purpose to qualify as an organization operated exclusively for an exempt purpose. Furthermore, an organization will not qualify for exemption if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

4. Organizations Exempt Under IRC 501(c)(3) Must Also Serve Public Interests

TR 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more IRC 501(c)(3) exempt purpose unless it serves a public rather than a private interest. Thus, to meet this requirement, 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.

5. Exempt Purposes

The list of permissible exempt purposes set forth in IRC 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals. The legal meaning of these categories has been developed in the TR and in rulings of various types interpreting the IRC and the TR.

a. Charitable

TR 1.501(c)(3)-1(d)(2) provides that the term charitable is used in IRC 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in IRC 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of charity as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

b. Educational

TR 1.501(c)(3)-1(d)(3)(i) provides that the term 'educational' as used in IRC 501(c)(3) is defined as the instruction or training of the individual for the purpose of improving or developing his capabilities

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or the instruction of the public on subjects useful to the individual and beneficial to the community. An organization may be educational even though it advocates a particular position or viewpoint.

6. Administrative and Judicial Rulings Pertaining to Credit Counseling Organizations

a. Revenue Rulings

(1) Revenue Ruling 65-299, 1965-2 C.B. 165

In Revenue Ruling 65-299, the IRS recognized a credit counseling organization open to the general public as exempt under Internal Revenue Code section 501(c)(4). The organization was incorporated as a nonprofit corporation to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. The organization was recognized as exempt under section 501(c)(4), because it:

- did not limit its services to those in need of such assistance as proper recipients of charity; employed specialists to interview applicants, analyze the specific problems involved, and counsel applicants on the payment of their debts;
- arranged a monthly distribution to creditors based on the debtor's ability to pay;
- communicated with creditors and, with the creditors' consent, set up plans which debtors agreed to follow;
- made its facilities available for debtors to make their monthly pro rata distributions to creditors;
- made no loans to applicants nor negotiated loans on their behalf;
- charged nominal fees to cover postage and supplies for its monthly prorating services;
- charged no fees for the counseling service; and
- relied upon voluntary contributions from local businesses, lending agencies, and labor unions to cover its costs of operations.

(2) Revenue Ruling 69-441, 1969-2 C.B. 115

In Revenue Ruling 69-441, the IRS determined that certain credit counseling organizations might meet the requirements of IRC 501(c)(3) because of their charitable or educational work. The organization limited its services to low-income individuals and families with financial problems. Its board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

To qualify for exemption under Internal Revenue Code section 501(c)(3), the organization:

- provided educational information to the general public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications;

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- assisted low-income individuals and families with financial problems by providing them with individual counseling and, if necessary, by establishing budget plans;
- serviced the budget plan by allowing the debtor to voluntarily make fixed payments through the agency; holding the funds in a trust account and disbursing the funds on a partial payment basis to the creditors, whose approval was obtained in advance;
- made no loans to debtors or negotiated loans on their behalf;
- charged no fees for counseling services or proration services - the debtor received full credit against his/her debts for all amounts paid; and
- relied upon voluntary contributions, primarily from the creditors participating in the organization's budget plans, for its support.

(3) IRC 501(c)(3) v. IRC 501(c)(4)

The IRS distinguished the facts in this ruling from the facts in Revenue Ruling 65-299 that held the organization was exempt under Internal Revenue Code section 501(c)(4):

- The agency in Revenue Ruling 65-299 was not engaged in any educational activities.
- The agency in Revenue Ruling 65-299 did not limit its assistance to a charitable class -- families or individuals in need of such assistance as proper recipients of charity.

b. Judicial Rulings

In Consumer Credit Counseling Service of Alabama v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978), the court held that a credit counseling organization may be exempt from Federal income tax even if it does not limit its clientele to low income individuals where the services provided by the organization are educational in nature. By ruling so, the court reversed the IRS in its revocation of the exempt status a credit counseling organization that provided credit counseling, but did not limit their services to low-income individuals.

The Consumer Credit Counseling Service (Agency) was an umbrella organization made up of numerous individual CO-3. It had been recognized as exempt under IRC 501(c)(3), and its activities were as follows:

- The Agency 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.
- The Agency also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families but did not limit these services to low-income individuals and families.
- The Agency charged a nominal fee of up to \$10 per month for some of their services, but waived the fee in instances where payment would work a financial hardship.

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- The Agency received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the CO-4. An incidental amount of their revenue was from the counseling fees. This was consistent with the fact that only 12 percent of the professional counselors' time was spent on debt management programs as opposed to education. The balance of time was devoted to the educational programs.
- The Agency was controlled by a community board of directors. The boards were required to have at least a 60 percent representation of the general public.

- The Agency were not controlled by or the captive of any creditor.

In 1976, relying on Revenue Rulings 65-299 and 69-441, the IRS notified the Agency that it had made a mistake and was reclassifying them under IRC 501(c)(4). The court, however, provided that the law does not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under IRC 501(c)(3). Organizations may be properly designated under IRC 501(c)(3) notwithstanding the fact that the general public is served.

Nonetheless, the Agency did not charge a fee for the programs that constitute their principal activities. A fee may be charged for a service that is an incidental part of an agency's function, but even where a fee is so charged it is nominal. Moreover, even this nominal fee is waived where payment would work a financial hardship.

The courts reached a similar decision in Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), where the facts and legal analysis were found to be virtually identical to those in Agency.

7. Other Administrative and Judicial Rulings

a. Revenue Rulings

(1) Counseling Activities Qualifying for Exemption Under IRC 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. Revenue Ruling 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Revenue Ruling 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Revenue Ruling 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Revenue Ruling 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Revenue Ruling 70-640, 1970-2 C.B. 117 (free marriage counseling); Revenue Ruling 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.

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(2) Private Benefit Does Not Necessarily Involve the Flow of Funds from an Exempt Organization to a Private Party

Revenue Ruling 76-206, 1976-1 C.B. 154, considered an organization formed to promote broadcasting of classical music in a particular community. The organization carried on a variety of activities designed to stimulate public interest in the classical music programs of a for-profit radio station, and thereby enable the station to continue broadcasting such music. The activities included soliciting sponsors, soliciting subscriptions to the station's program guide, and distributing pamphlets and bumper stickers encouraging people to listen to the station. The organization's board of directors represented the community at large and did not include any representatives of the for-profit radio station. The revenue ruling concludes that the organization's activities enable the radio station to increase its total revenues and therefore benefit the for-profit radio station in more than an incidental way. Therefore, the organization is serving a private rather than a public interest and does not qualify for exemption.

b. Judicial Rulings

(1) A Substantial Nonexempt Purpose Destroys the Exemption

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945), the Better Business Bureau ("BBB") claimed that it qualified as a corporation organized and operated exclusively for scientific or educational purposes, and hence it was entitled to exemption from social security taxes under section 811(b)(8) of the Social Security Act. The Court, however, held that the presence of a single nonexempt purpose, if substantial in nature, would destroy the exemption regardless of the number or importance of truly exempt purposes.

Better Business Bureau ("BBB") was organized in 1920 as a non-profit, non-stock corporation under the laws of the District of Country. BBB was formed to promote ethical business practices, educational and scientific advances, and profitability in the business community.

In carrying out its purposes, BBB divided its work roughly into five subdivisions:

- (1) Prevention of fraud by informing and warning members and the general public of the plans and schemes of various types of swindlers;
- (2) Fighting fraud by bringing general and abstract fraudulent practices to the attention of the public;
- (3) Elevation of business standards by showing and convincing merchants that the application of "the doctrine of caveat emptor is not good business" and by showing and convincing them that misleading advertising, extravagant claims and price comparisons are not good business;
- (4) Education of consumers to be intelligent buyers; and
- (5) Cooperation with various governmental agencies interested in law enforcement.

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BBB compiled information to warn its members and the general public of fraudulent schemes and practices. The information was available to anyone without charge and was communicated to the members and the public by means of the radio, newspapers, bulletins, meetings and interviews. By doing so, merchants were taught to conduct their businesses honestly, while consumers were taught to avoid being victimized and to purchase goods intelligently.

In this instance, in order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes. It thus becomes unnecessary to determine the correctness of the educational characterization of petitioner's operations, it being apparent beyond dispute that an important, if not the primary, pursuit of petitioner's organization is to promote not only an ethical but also a profitable business community. The exemption is therefore unavailable to petitioner.

The commercial hue permeating petitioner's organization is reflected in its corporate title and in the charter provisions dedicating petitioner to the promotion of the "mutual welfare, protection and improvement of business methods among merchants" and others and to the securing of the "educational and scientific advancements of business methods" so that merchants might "successfully and profitably conduct their business." Petitioner's activities are largely animated by this commercial purpose. Unethical business practices and fraudulent merchandising schemes are investigated, exposed and destroyed. Such efforts to cleanse the business system of dishonest practices are highly commendable and may even serve incidentally to educate certain persons. But they are directed fundamentally to ends other than that of education. Any claim that education is the sole aim of petitioner's organization is thereby destroyed.

(2) Business purpose is the Primary Goal and Earnings Inured to the Benefit of Its President.

In Easter House v. United States, 12 Cl. Ct. 476 (1987), the court held that organization was not entitled to declaratory relief in its action against the federal government where a portion of its earnings inured to the benefit of its president.

Easter House operated as a for-profit corporation beginning in 1960. In 1983, it amended its articles of incorporation to become a non-profit corporation, and it applied for tax-exempt status under IRC 501(c)(3).

The IRS denied Easter House's application, stating that Easter House operated in a manner not "distinguishable from a commercial adoption agency." The IRS concluded that a substantial purpose of Easter House's activity was commercial and hence that Easter House was not operated exclusively for tax-exempt purposes, as required by IRC 501(c)(3). The IRS also found that Easter House had not shown that no part of its net earnings inured to the benefit of a private individual.

Easter House's income derives entirely from the fees charged to adoptive parents; it does not solicit contributions, it does not seek or receive funding from any governmental source, and it does not use any volunteers to assist its paid staff of 15-20 persons.

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Seymour Kurtz is Easter House's president and its sole "life member," which gives him the power to appoint all of the other directors. Under Easter House's bylaws, these positions vested sweeping power in Kurtz, including the power to decide what corporate affairs will be managed by the life member alone.

At all relevant times, Kurtz was also involved, either as the sole owner or as a director, with three other organizations engaged in adoption-related activities. Easter House engaged in financial transactions with each of these three entities, including an \$86,681 loan to one of the organizations, which was uncollectible because the debtor became inactive and without assets.

The Claims Court sustained the IRS's position. The court held that Easter House was operated for the substantial commercial purpose of earning profits from placing children for adoption. The court also agreed that Easter House had failed to show that no part of its net earnings inured to the benefit of a private individual. Indeed, pointing to Kurtz's use of Easter House as a "private source of loan credit" and to what the court found to be excessive compensation, the Claims Court concluded that part of Easter House's net earnings "clearly inured to the benefit of Kurtz". The court of appeals affirmed, agreeing with the Claims Court that Easter House failed to qualify as a tax-exempt organization both because it was not operated primarily for charitable purposes and because a substantial part of its net earnings inured to Kurtz.

The factual conclusions of both courts below that Easter House failed to qualify for IRC 501(c)(3) tax exemption on both of these grounds were amply supported by the record. In particular, Easter House charged adoptive parents high fees that yielded substantial profits. In 1983, Easter House made a profit of more than \$257,000 (a 25% margin), and it also generated large reserve accumulations.

This fact, coupled with the fact that, as a general rule, Easter House's services were reserved exclusively for women who decided to place their children with Easter House for adoption and for adoptive parents who could afford to pay the fixed fees, strongly supported the finding that Easter House's purpose was largely commercial, not charitable. By the same token, the inurement finding was supported by Kurtz's use of Easter House as a source of credit for other entities that he controlled.

(3) Private Interests Benefiting more than Incidentally does not further an Exempt Purpose

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36; 1989, the court held that an organization is not operated exclusively for one or more exempt purposes under IRC 501(c)(3) if a substantial non-exempt purpose of an organization's operations was to provide benefit for a for-profit tour agency.

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International Postgraduate Medical Foundation (Foundation) was founded by Michael Helin who also is Foundation's original chief executive officer. Since its inception, Foundation has organized, sponsored and co-sponsored seminars and symposia in the medical field. Its stated purpose is to provide continuing medical education to physicians.

Mr. Helin had control of the daily operations of Foundation. Mr. Helin served as trustee without salary or compensation in recognition of Foundation's regular use of his travel agency, H & C Tours, to arrange the tours for Foundation's seminars.

H & C Tours is a for-profit travel agency of which Mr. Helin is a shareholder and the president. Foundation used H & C Tours exclusively for all travel arrangements.

Foundation and H & C Tours entered into a Travel Services and Administrative Support Agreement which allowed competitive bids for travel arrangements, but required acceptance of H & C Tours' price if within 2.5 percent of any competitive bid. There is no evidence that Foundation solicited competitive bids from any entity other than H & C Tours.

Foundation physically located its office within the offices of H & C Tours. H & C Tours provided Foundation's secretarial, clerical and administrative personnel for a fee equal to H & C Tours' cost. Such services are only available to petitioner during "reasonable, nonconflicting business hours."

Foundation's program is to take physicians on tours throughout the world, each lasting about three weeks. Continuing medical education seminars are provided during the tours. Foundation's brochures emphasize the sightseeing and recreational component of the tours. The brochures do not describe the medical curriculum for the seminars and symposia. Mention of medical education in the brochures is limited to a statement that participation qualifies for American Medical Association Category One Credit.

Educational activities occurred on less than one-half of the days on a typical tour. An average of 4-1/2 hours were devoted to educational activities on such days.

The IRS alleged that Foundation's operations include two substantial nonexempt purposes: (1) benefit for H & C Tours and Helin; and (2) sightseeing and recreation activities.

The court held that Foundation is not operated exclusively in furtherance of purposes described in IRC 501(c)(3), because a substantial purpose of Foundation's operations was to increase the income of H & C Tours:

- H & C Tours benefits from the distribution and production of brochures which solicit customers for tours arranged by H & C Tours.
- Approximately 90 percent of petitioner's total revenue for 1977 was expended on production and distribution of brochures.

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- The terms of the Travel Services and Administrative Support Agreement further insured that H & C Tours would substantially benefit from Foundation's operations.
- Foundation did not solicit competitive bids from any travel agency other than H & C Tours.
- In 1977, H & C received \$ 339,667 in gross revenue for air fares and land arrangements as a direct result of Foundation's tours.
- Mr. Helin controlled petitioner and exercised that control for the benefit of H & C Tours.
- Foundation spent about 90 percent of its total revenue for 1977 on production and distribution of brochures. The brochures provided a direct benefit to H & C Tours in the form of air and land travel billings.

The court further held that Foundation did not provide a bona fide medical education program:

- Foundation's brochures heavily emphasize the recreational sightseeing activities of the tours.
- Continuing medical education course descriptions are not included in Foundation's brochures.
- Foundation has not established that the recreational sightseeing activities were insubstantial or only incidental to petitioner's educational purposes.

(4) Prohibited private interests include those of unrelated third parties as well as insiders

In Christian Stewardship Assistance, Inc., v. Commissioner, 70 T.C. 1037; 1978, the court held that an organization's tax planning services are a nonexempt activity that is substantial in nature and not incidental to its charitable purpose. Therefore, CSA fails to qualify for exemption from taxation.

Christian Stewardship Assistance, Inc. ("CSA") was formed as a nonstock corporation to support and assist charitable organizations as they fulfill their exempt charitable activities by assisting such organizations in their relationships with their contributors and in stimulating proper application of Christian stewardship principles among their contributors.

In furtherance of these purposes, CSA engaged in financial counseling by providing a financial planning service to wealthy individuals who have contributed to various Christian organizations and whose net worth exceeded one-half million dollars.

The counseling given by CSA consists of advice on how to increase a contributor's current or deferred donations to Christian organizations. CSA prepared a financial plan for a contributor that takes into account his personal goals and the applicable tax savings. The financial plan is developed to permit increased current or deferred donations by rearranging the inter vivos or testamentary disposition of the individual's assets to family members. The rearrangement also results in a reduction of Federal income and estate taxes. Tax and cost estimates comparing

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results under present and suggested financial plans are prepared by CSA with accompanying charts illustrating the effects of the suggested plan on family and Christian interests. CSA also assists the individual's attorney in implementing the financial plan chosen by the individual.

To reimburse its costs of operation, CSA charged a fee to each subscribing organization based upon a percentage of its developmental budget. Support is also received in the form of voluntary donations from individuals whom it assists. Individuals who are assisted are neither billed for, nor informed of, the costs of the counseling they receive.

In 1977, the IRS issued a final notice of determination, affirming a prior adverse determination, which denied exemption under IRC 501(c)(3). The IRS determined that the described activities, although helpful to charitable organizations, are not exclusively for charitable purposes, but rather serve private interests by advising individuals about methods to decrease Federal income and estate taxes.

CSA, on the other hand, contends that its founders have not benefited monetarily and its clients have not benefited economically from the services offered by its organization; rather, it is the charitable organizations to which gifts are made which receive the greatest economic benefit from CSA's work.

The court held that CSA failed to qualify for exemption under the operational test because its organization was not operated exclusively for charitable purposes. Its sole financial planning activity, albeit an exempt purpose furthering Christian fundraising efforts, has a nonexempt purpose of offering advice to individuals on tax matters that reduces an individual's personal and estate tax liabilities. Based upon those private benefits offered, we find the nonexempt purpose to be greater than the exempt purpose.

(5) An Educational Corporation Was Not Exempt Because Its Income-Producing Activities Were Not Incidental to Its Educational Activities

In est of Hawaii v. Commissioner, 71. T.C. 1067 (1979), aff'd in unpublished opinion, 647 F.2d 170 (9th Cir. 1981), the tax court found that for-profit "est" entities were able to use est of Hawaii, a non-profit organization, as an instrument to further their for-profit purposes even though the for-profits lacked structural control over the nonprofit, due to the significant indirect control exerted by the for-profits.

est of Hawaii (Hawaii) is a corporation which was organized as a nonprofit corporation. "est" stands for "Erhard Seminars Training" and encompasses the general theory, the body of knowledge, and the method and techniques which are used in "est" programs and were developed by Werner Erhard.

The "est" programs deal with the areas of intrapersonal awareness and communication. The standard "est" training is a 52-hour session held on 2 consecutive weekends with groups of 200 to 250 people. These sessions are conducted by persons who are called "trainers." Graduates of the standard training participate in regular activities called "seminars."

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Activities related to "est" are conducted by several corporations, including three for-profit corporations, Erhard Seminars Training (EST, Inc.), Presentaciones Musicales, S.A. (PMSA), and EST International (International). The three entities entered into a royalty agreement with the sole objective of establishing a system for the presentation of "est" to the public through the organization of tax-exempt corporations covering different geographical areas throughout the United States.

Hawaii was incorporated by "est" graduates as the first step in the implementation of the royalty agreement. Their objective is to develop and expand the principles and concepts of "est." They intend to provide "est" training and seminars, to develop, promote, and sell "est" publications, engage in "est" educational work, provide "est" lectures, and generally engage in related educational efforts in the State of Hawaii.

Membership in Hawaii is limited to graduates of the training designated "Erhard Seminars Training." In order to retain membership status, an individual must vote in the election of the directors of the corporation at least once in the first 3 years and once in every successive group of three elections. To be eligible for election to the board of directors, an individual must be a resident of Hawaii and a graduate of "Erhard Seminars Training." Directors and officers receive no compensation for their services.

Hawaii entered into an agreement with International which incorporated the royalty agreement. The licensing agreement provided, in pertinent part, as follows:

- The agreement shall license Hawaii for the period August 15, 1973, to December 31, 1974, inclusive. The license shall continue on an annual basis without the necessity for renewal until August 8, 1983.
- Hawaii shall use all EST materials under the direction of an EST trainer.
- Hawaii shall conduct EST trainings, seminars and lectures and generally to promote EST concepts in accordance with EST principles.
- Hawaii shall charge not less than \$ 200.00 as tuition for any EST training.
- One half of all of the gross proceeds of any EST event or activity other than regular monthly seminar series conducted by Hawaii shall be paid to International.
- Hawaii shall conduct regular EST seminars.
- Hawaii shall sponsor and host special events and special appearances of Werner Erhard and other EST trainers and speakers, with prior notice and prior discussion.
- EST, Inc. shall supply a trainer to Hawaii to carry out management responsibilities for a period not to exceed twenty four months from August 15, 1973.
- EST, Inc., shall supply Hawaii management and training.
- Hawaii shall pay to International 50% of the gross receipts collected by Hawaii for EST training courses.

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Hawaii expects to derive all its assets from student fees, lecture admissions, and occasional donations. Hawaii does not intend to utilize fund-raising programs.

Hawaii claims that it has no connection, direct or indirect, with EST, Inc., or International and that its transactions with International are reasonable and represent the fair market value of the rights and services it receives in return. On this premise, Hawaii argues that it has no commercial purpose of its own, that its payments to International are analogous to ordinary and necessary business expenses, and that the fact that International may make a profit is not a ground for denying Hawaii tax-exempt status.

The IRS, on the other hand, claims that Hawaii is part of a franchise system which is operated for private benefit and that its affiliation with this system taints it with a substantial commercial purpose.

The court agreed stating that while it may be true that they are not formally controlled by the same individuals, International exerts considerable control over Hawaii's activities:

- It sets the tuition for the standard training and requires a minimum number of such trainings.
- It requires Hawaii to conduct regular seminars and to host special events.
- It controls the programs conducted by Hawaii by providing trainers who are salaried by and responsible to EST, Inc.
- It further controls Hawaii's operations by providing management personnel who are paid by and responsible to EST, Inc.

In short, the court provided that Hawaii's only function is to present to the public for a fee ideas that are owned by International with materials and trainers that are supplied and controlled by EST, Inc. Under these circumstances, the court stated that it can hardly be said that Hawaii has made payments to a corporation with which it had no connection whatsoever.

Regardless of whether the payments made by Hawaii to International were excessive, the court held that International and EST, Inc. benefited substantially from the operation of Hawaii. For instance,

- Pursuant to the licensing agreement, International was in a position to license Hawaii for a maximum of 10 years.
- Upon termination, all copyrighted material, including new material, is required to be transferred to EST, Inc., or International.
- Hawaii is required to use its excess funds for the development of "est" or related educational and scientific research.
- Although Hawaii would be reimbursed at cost for all new developments, it has no right to the continued use of such developments.

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To the extent that Hawaii's activities increase interest and participation in "est" and to the extent Hawaii further develops "est," the ultimate beneficiaries are EST, Inc., International, and PMSA, the corporations in which the rights to "est" remain. Other factors indicate that Hawaii is operated for commercial purposes include:

- Trainers and local organizations are required to sign an agreement not to compete with "est" for 2 years after terminating their relationship with "est" organizations.
- Hawaii does not expect to derive funds from donations, as is typical of IRC 501(c)(3) organizations, but rather will depend upon tuition and lecture fees.
- Tuition for the standard training is set by a for-profit corporation and fees for lectures are set, not with regard to recouping costs, but with regard to the eminence of the speaker.

Accordingly, the court held that Hawaii is not operated exclusively for exempt purposes.

IV. GOVERNMENT POSITION

1. Conclusion

In applying the principles described above to ORG's exemption, we must ask the following related questions:

- Does ORG further a nonexempt purpose in contravention of IRC 501(c)(3)?
- If so, is the nonexempt purpose substantial?

After a long and careful review of the records, we hold that ORG is not entitled to exemption under IRC 501(c)(3), for the reasons as follows:

- ORG is engaged primarily in activities that accomplish a nonexempt purpose in contravention of IRC 501(c)(3) and IRC 170(c)(2)(B);
- More than an insubstantial part of such activities are in furtherance of a non-exempt purpose in contravention of IRC 501(c)(3) and IRC 170(c)(2)(B);
- Part of ORG's net earnings inured to the benefit of any private shareholder or individual in contravention of IRC 501(c)(3) and IRC 170(c)(2)(B); and
- ORG is operated for the purpose of serving private rather than public interests in contravention of IRC 501(c)(3) and IRC 170(c)(2)(B).

2. Criteria for Tax Exemption under IRC 501(c)(3)

Under IRC 501(a), an organization is exempt from federal income tax only if it falls within one of the specific classes that are described in IRC 501(c). Public charities and private foundations, which

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comprise the best-known class, are conferred exemption under IRC 501(c)(3). Organizations qualifying for exemption under IRC 501(c)(3) must meet the following requirements:

- it must be organized and operated exclusively for one or more religious, charitable, scientific, testing for public safety, literary or educational purpose, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals;
- its net earnings may not inure to the benefit of any private shareholder or individual;
- no substantial part of its activities may be the conduct of propaganda or otherwise attempting to influence legislation; or
- it may not participate in, or intervene in any political campaign on behalf of or in opposition to a candidate for public office.

An organization's failure to satisfy any of the four requirements is fatal to its qualification under IRC 501(c)(3). See Levy Family Tribe Foundation v. Commissioner, 69 T.C. 615, 618 (1978). In addition to satisfying each condition specified in IRC 501(c)(3), the exempt organization must also establish that its purpose is not contrary to public policy. See Bob Jones University v. United States, 461 U.S. 574, 591-593 (1983).

3. Application of the Organizational and Operational Tests

The starting point for our analysis is IRC 501(c)(3) and the Regulations thereunder. In order to qualify under IRC 501(c)(3), NHF must pass a dual test, which is referred to as an organizational and operational test, pursuant to TR 1.501(c)(3)-1(a)(1). Under the dual tests, an organization must be both organized and operated exclusively for one or more exempt purpose as defined in IRC 501(c)(3). If an organization fails to meet either the organizational test or the operational test, it is not exempt.

a. Organizational Test

Under the organizational test, an organization is organized exclusively for exempt purposes only if the articles of organization are so drawn that it: (1) limits the purposes of the organization to one or more exempt purpose; and (2) does not expressly empower the organization to engage (otherwise than as an insubstantial part of its activities) in activities which in themselves are not in furtherance of one or more exempt purposes. See TR 1.501(c)(3)-1(b)(1).

The organizational test relates to the rules for governing an organization and the purposes stated in its articles of incorporation. ORG is organized exclusively for charitable and educational purposes as described in IRC 501(c)(3). Henceforth, we do not question ORG's qualification for exemption under the organizational test.

b. Operational Test

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In contrast, under TR 1.501(c)(3)-1(c)(1), the operational test 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 IRC 501(c)(3).

According to the courts, the operational test focuses on the purpose towards which an organization's activities are directed, and not the nature of the activities themselves. In other words, the purpose of the activity is ultimately determinative of the organization's right to be classified as an IRC 501(c)(3) organization. See B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352, 356-357 (1978). Thus, the question herein is whether ORG is operated exclusively for charitable and educational purposes.

4. ORG's Exempt Purpose and Activities that Further Its Exempt Purpose

Pursuant to Regs 1.501(c)(3)-1(c)(1), ORG contends that its purposes are exclusively charitable and educational. In furtherance of such purposes, ORG operates an inbound telemarketing call center which provides assistance to individuals who are experiencing financial and debt-related difficulties. For example, ORG claims it provides debt consolidation services (i.e., debt management program); counseling on credit and budget matters; and newsletters on financial related issues.

5. ORG is Engaged Primarily In Activities That Accomplish A Nonexempt Purpose.

During the year under examination and the five-year period ending in fiscal year June 30, 20XX, ORG's primary activity was the operation of an inbound telemarketing call center, where calls originate with the respondents (callers). Such calls were made in response to a marketing offer directed via print, radio, TV or other media sources. The callers generally contact the call center by phone to ask for help.

In this case, the purpose for which the call center was operated and the marketing offers were geared is to enroll consumers in ORG's debt management program. Under the debt management program, ORG's credit counselors determine whether callers qualify for enrollment in the debt management program by simply determining whether callers have a net cash flow after expenses. If qualified, a consumer need only return the application signed.

Once in the program, the consumer is called a client (or a member). Under the agreement, the client deposit money each month with ORG, which then uses these deposits to pay the client's credit card bills, student loans, medical bills, or other unsecured debts according to a payment schedule ORG has worked out with the client and the client's creditors. Creditors may agree to lower interest rates or waive certain fees if the client is repaying through a debt management program.

Any consumer may enroll in the debt management program, without regard to financial status.

The purpose of ORG's activities differs substantially from those of the organizations cited in Revenue Ruling 65-299, Revenue Ruling 69-441, and CO-2 of State. Although ORG has engaged in educational activities (e.g., disseminating self-help booklets to the general public and two

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newsletters to its clients), such activities are incidental. As shown below, ORG derived nearly all of its revenue from the debt management program, which also encompasses nearly all of ORG's program services expenditures. It's clear that the primary focus of the call center is to enroll consumers in the debt management program.

Form 990 - Sources of Revenues

	30-Jun 19XX	30-Jun 20XX	30-Jun 20XX	30-Jun 20XX	30-Jun 20XX
Revenue					
Fair share income					
Debt management fees					
Interest on savings					
Dividends and interest					
Total Revenue					

Fair Share and Debt Management as a % of Total Revenue

Program Service Expenses per Form 990

Description	31-Dec 19XX	30-Jun 19XX	30-Jun 19XX	30-Jun 20XX	30-Jun 20XX	30-Jun 20XX
Debt Management Program (DMP)						
Education Program						
Total						

DMP as a % of Total Program Service Expense

For ORG's exemption to remain intact, its debt management program must be shown to further an exempt purpose. In determining whether credit counselors have provided counseling within the meaning of the Revenue Rulings cited above, we examined the training materials ORG provided to its new credit counselors. Other than vague references to "educating" or "counseling" the caller, we found nothing of substance. For instance, the initial interview training script, counselor protocols and

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training manual are each oriented to enrolling consumers in the debt management program. Other factors we've uncovered include:

- Even though counselors receive Form W-2, they are paid on a draw plus commission basis;
- The payment of bonuses are based on the number of debt payments received by ORG;
- Several counselors whom we've interviewed have stated that their job was to enroll consumers in the debt management program and that ORG did not train counselors how to provide counseling services;
- If education were provided to callers, it was as a result of the counselors own education and experience;
- The Software program is used by credit counselors solely to determine whether callers qualify for the debt management program in accordance with the program's design;
- The Software program also tracks counselor productivity and measures counselor performance;
- The CO-52 Business Valuation Report and the Minutes of Meeting of the Board of Directors refer to counselors as "salesman."
- ORG's marketing efforts, including the issuance of "consumer awareness" articles and media releases, are an effort by ORG to increase its commercial success.

Because the debt management program constitutes the call centers primary activity, we find the principal purpose behind such program to be commercial in nature.

6. More Than an Insubstantial Part of Such Activities Further a Non-Exempt Purpose

In *Better Business Bureau v. United States*, the Supreme Court provided an exemption for corporations organized and operated exclusively for educational purposes, said:

*in order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes. * * * [326 U.S. at 283.]*

This philosophy, in somewhat modified form, has been promulgated in TR 1.501(c)(3)-1(c)(1), which provides:

An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which 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.

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The quotation from Better Business Bureau above relates to "purpose" while the TR quoted above deals more with "activities." Under the rationale of Better Business Bureau the existence of a substantial nonexempt purpose for a corporation's organization and existence would appear to defeat the exemption. But under the regulation, even if there was no nonexempt purpose for the organization and existence of the entity, it must actually engage primarily in activities which accomplish one of the exempt purposes, and if more than an insubstantial part of its activities do not further such exempt purpose, the entity is not exempt.

Having decided that ORG's primary activity was the operation of an inbound telemarketing call center and that the purpose for which such activity was conducted was to enroll consumers in the debt management program, a nonexempt, commercial purpose, we must then determine whether such nonexempt purpose was substantial.

ORG does not receive charitable contributions from the general public. Nor does it receive grants from governmental institutions and private foundations. Its primary source of revenue is fair share income and debt management fees. For the five-year period ending in June 30, 20XX, approximately 99 percent of ORG's revenues are derived from fair share income and debt management fees. As a result, we found the nonexempt, commercial purpose to be substantial.

7. Part of ORG's Net Earnings Inured to the Benefit of PRESIDENT

Pursuant to IRC 501(c)(3), an organization does not qualify for tax exempt status if any of its net earnings inures to the benefit of any private shareholder or individual. The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity. . . ." United Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 19XX).

In TR 1.501(c)(3)-1(d)(1)(ii), an organization is not organized and operated exclusively for IRC 501(c)(3) purposes if it serves a private rather than public interest.

TR 1.501(c)(3)-1(c)(2)(c) provides that the phrase "private shareholder or individual" refers to persons having a personal and private interest in the activities of the organization.

In Easter House, the court held that a substantial purpose of Easter House's activity was commercial and that earnings inured to the benefit of the president who used Easter House as a source of credit for other entities that he controlled.

For all intents and purposes, ORG is a shell organization operated as a conduit through which charitable assets are diverted to six for-profit entities owned and controlled by PRESIDENT, the founder of ORG. The factors that indicate ORG's shell status are as follows:

- Thin capitalization per balance sheet.** ORG's assets are siphoned off to six for-profit entities via related party transactions.

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- Absence of corporate assets.** ORG leases all of its furniture, fixtures and equipment from CO-14 and its office space from CO-15
- Minutes of meeting of the board of directors.** Other than the related party transactions, the minutes do not discuss the business and affairs of ORG;
- The use of the same office or business location.** Five of the six related entities share the same office location.
- The treatment by an individual of the corporate assets as his own.** PRESIDENT and Vice President both received substantial reimbursement of personal credit card expenditures which ORG could not provide documentation substantiating the nature of the expenditures.
- The identification of _____ as having dominion and control over ORG and the related for-profit entities.** PRESIDENT is the founder, president and chairman of ORG, and either the sole owner or principal owner of the related, for-profit entities.
- Concealment of the identity of CO-50.** Clients do not know that when they contact the Customer Service department or another back office administrative department, they are contacting another organization.
- Commingling of assets.** The credit card reimbursements included the purchase of office supplies. Since documentation is not available, it is not known which entity benefited from the transaction.

In this case, ORG's income-producing commercial activities are the very justification for its existence. ORG was simply the instrument to subsidize the related for-profit entities and not vice versa and had no life independent of those related for-profit entities. See est of Hawaii and International Postgraduate Medical Foundation.

Moreover, the related for-profit entities all are dependent on the existence of ORG's tax-exempt status - an element that indicates the possibility, if not likelihood, that the for-profit corporations were trading on such status. See and compare Berenson v. Commissioner, 507 F.2d 262, 268-269 (2d Cir. 1974), revg. in part on other grounds 59 T.C. 412 (1972). See also Commissioner v. Brown, 380 U.S. 563 (1965), Judge Harlan concurring, at 579-580, and Judge Goldberg dissenting, at 580.

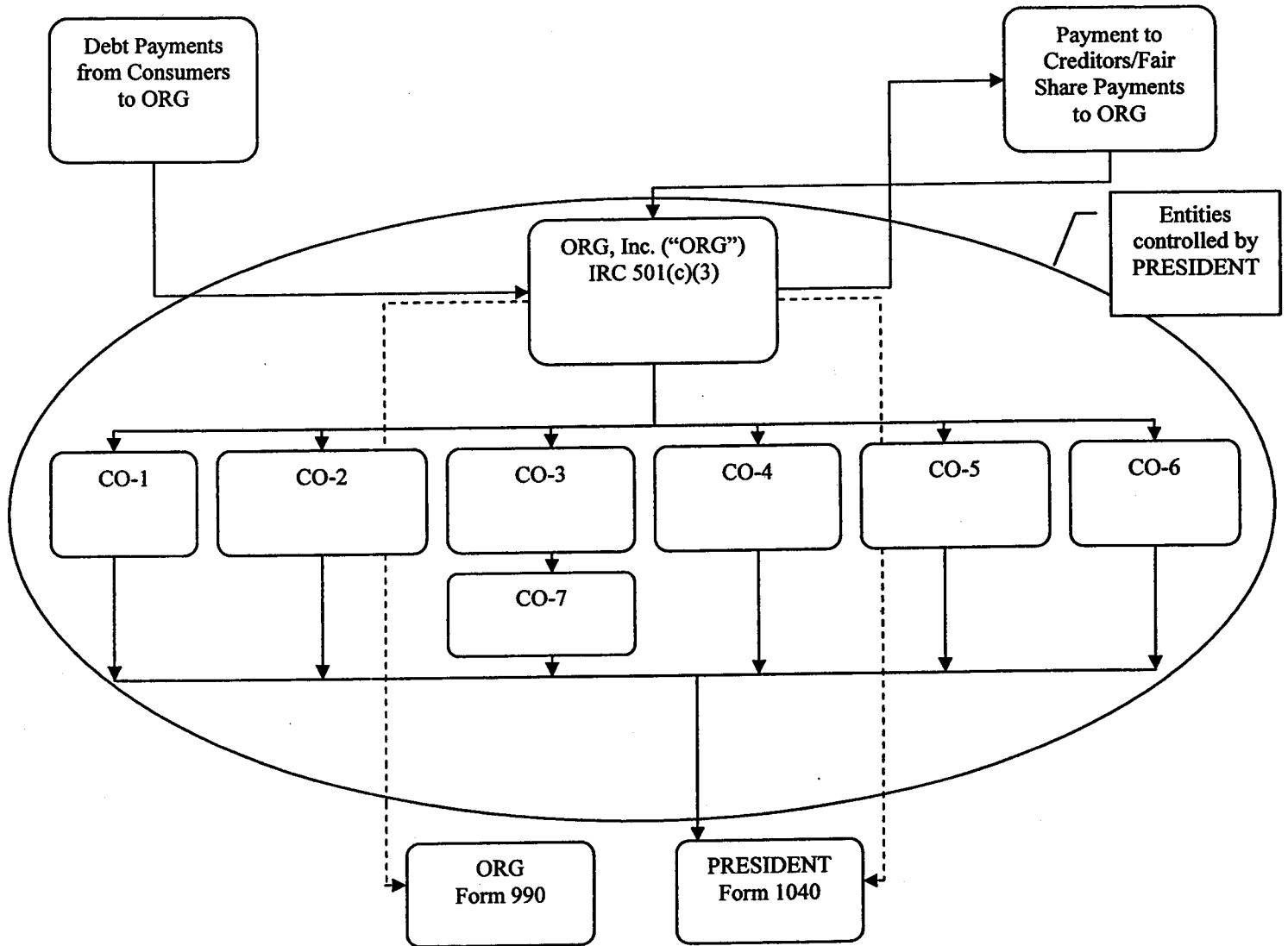
As was the case with Christian Stewardship Assistance and est of Hawaii, the prohibited private interests also includes those of unrelated third parties. The debt management program was not limited to a charitable class and ORG did not have an established policy or procedure to waive or reduce the fees for the indigents or to waive the fees for those to whom such fees would create financial hardship. Consequently, the debt management program did not serve a charitable purpose. See also Old Dominion Box Co., Inc., v. United States, 477 F. 2d 340 (4th Cir. 1973), cert. denied, 413 U.S. 910 (1973), where the court held that an organization operating for the benefit of private parties who are not members of a charitable class constitutes such a substantial nonexempt purpose.

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V. CONCLUSION

ORG is not operated exclusively for educational or for any other exempt purposes within the meaning of IRC 501(c)(3) since its primary activity is the sale of debt management plans. ORG conducted incidental educational activities within the community, provided no educational training or counseling to consumers on credit or debt management issues, and did not provide education in the context of sales of its debt management plans. The debt management program was not limited to a charitable class and ORG did not have an established policy or procedure to waive or reduce the fees for the indigents or to waive the fees for those to whom such fees would create financial hardship. Consequently, the debt management program did not serve a charitable purpose. Since the primary activity of ORG was the sale of debt management plans which lacked substantial educational or charitable aspects, its exemption under IRC 501(c)(3) should be revoked effective July 1, 20XX.

Flow of Cash to President Exhibit 1



LEGEND

ORG - Organization name
1st through 8th COMPANIES

XX - Date

President - president

CO-1 through CO-8 -

Flowchart Notes:

- A. After qualifying and enrolling in the Debt Management Program, consumers consolidate their monthly debt payments into one debt payment to ORG who receives an initial fee and monthly fees thereafter.
- B. Twice per month, ORG distributes debt payments to creditors on behalf of their clients.
- C. Creditors pay fair share income to ORG.

Flow of Cash to President Exhibit 1

D. Payments to related entities:

Related Entities:	Description of Services:	EIN:	Address:	Total Payment:
CO-1.	Back Office Processing Services		ADDRESS CITY, STATE	
CO-2.	Software Lease		ADDRESS CITY, STATE	
CO-3	Client Benefits, e.g., coupons		ADDRESS CITY, STATE	a
CO-4.	Advertising Consulting Services		ADDRESS CITY, STATE	
CO-5	Rent		ADDRESS CITY, STATE	
CO-6.	Office Equipment Rental		ADDRESS CITY, STATE	

a. Payments provided by ORG but not reported in the general ledger.

E. Per its 20XX06 Form 990, ORG generates the following revenues from its Debt Management Plan:

Revenue:	Total
Program Service Revenue (or Fair Share Income):	
Membership Fees:	_____
Revenue from Fair Share and Membership Fees	=====

F. Per BRTVU research, the following amounts were distributed to President from his related entities:

Related Entities	Entity Type	31-Dec-XX	31-Dec-XX	21-Dec-XX
CO-1.	S-Corporation			
CO-2.	S-Corporation			
CO-3	Limited Liability Company			
CO-4.	S-Corporation			
CO-5	Limited Partnership			
CO-6.	S-Corporation	_____	_____	_____
		=====	=====	=====

Note:

Based on IDRS research, we Determined that CO-8 is a non-filer. It's parent, CO-7, also is a non-filer.

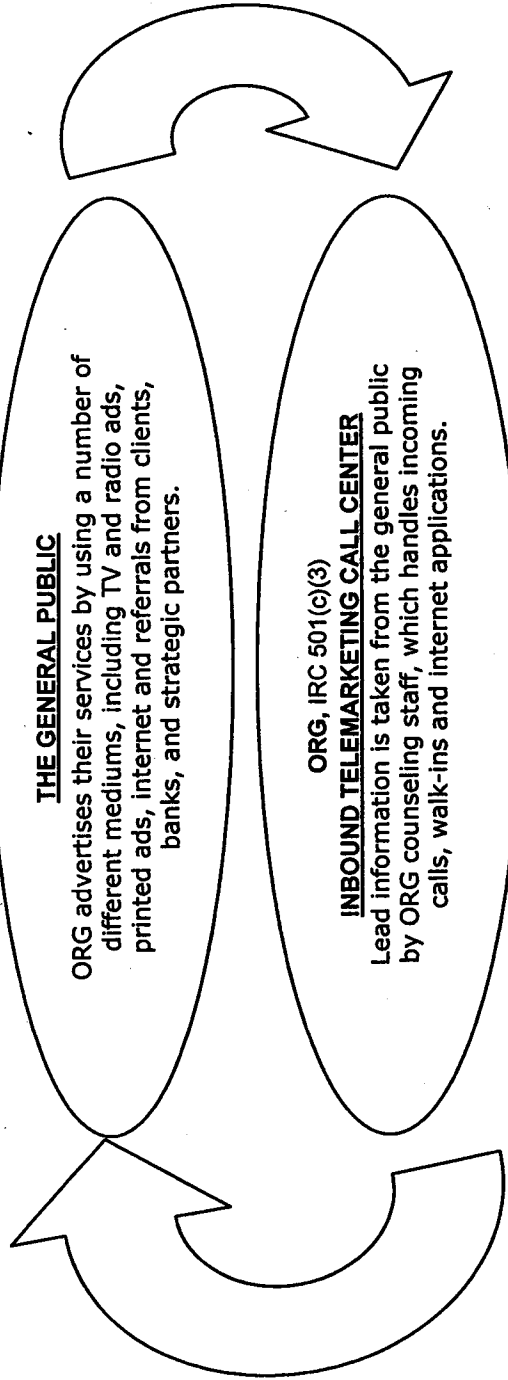
G. Per Form W-2, President received the following amounts as salary from ORG for calendar years 20XX and 20XX:

Name	Tax Form	31-Dec-XX	31-Dec-XX	21-Dec-XX
President	Form 1040			

Flow of Cash to President
Exhibit 1

THE LIFE CYCLE OF AN ACCOUNT

Exhibit 2



CO-1 For-profit related entity

BACK OFFICE SERVICE PROVIDER

Processing Department: After the client's application is received, an account is set up. The client is advised of the plan's terms and the proposal is sent to the client's creditors.

Customer Service Department: The objective of this department is account retention. It is provides three services: (1) Client Services; (2) Account Analyst; and (3) Collections. Client Services answers incoming calls from clients and creditors, handling inquiries, account maintenance, referring client research issues to other functions, updating proposals and statements. Account Analyst researches and solves problems. It also attends to client faxes, e-mails, and statements, but its emphasis is on creditor relations. Collections contacts clients to ensure their continued compliance with the terms of their debt management plan agreement.

Payoff Department: Contact creditors to confirm the payoff amount owed and follow through with the disbursement of the payoff amount. After the client's last disbursement, this department mails completion material to the client.