DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200919053**
Release Date: 5/8/2009

January 23, 2009

LEGEND
ORG = Organization name XX = Date Address = address
UIL:501.03-01

ORG
ADDRESS

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN:

CERTIFIED MAIL - RETURN RECEIPT

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: April 23, 20XX

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX. You have agreed to this change per signing of the Form 6018, dated August 26, 20XX.

Our adverse determination was made for the following reasons:

> Inurement and/or private benefit of an IRC Section 501(c)(3)'s assets in any form or amount is prohibited. ORG has not been operating exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). ORG so is not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. You operate substantially for a non-exempt purpose; the providing of private rather than public benefits.

You failed to meet the requirements of IRC section 501(c)(3) and Treas. Reg. section 1.501 (c)(3) -1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for a substantial non-exempt purpose; providing debt negotiation and debt settlement services.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code. You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

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

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling:, or writing:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax 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.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Renee B. Wells
Acting, Director EO
Examinations

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
1100 Commerce, EO:7994
Dallas, Tx 75242

August 26, 2008

Taxpayer Identification Number:

POA
ADDRESS

Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

Dear :

We are sending the enclosed material under the provisions of your power of attorney or other authorization on file with us. For your convenience, we have listed the name of the taxpayer to whom this material relates.

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,

Renee B. Wells
Acting Director, EO Examinations

Enclosures:
Final Letter

Taxpayer name: ORG

LEGEND
ORG = Organization name XX = Date XYZ = State Address =address
City = city President = president RA = RA Manager = manager CO-1 = 1st company

Issues:

1. Whether ORG is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3):

a. Whether ORG is engaged primarily in activities that accomplish an exempt purpose?
b. Whether more than an insubstantial part of ORG's activities are in furtherance of a non-exempt purpose?
c. Whether ORG was operated for the purpose of serving a private benefit rather than public interests?
d. Whether any part of the net earnings of ORG inured to the benefit of any private shareholder or individual?

Facts:

ORG was incorporated under the laws of the State of XYZ as a non-stock, nonprofit corporation on July 24, 20XX. In a determination letter dated May 23, 20XX, ORG was determined to be exempt from federal income tax as an organization described in IRC, section 501(c)(3). ORG is located at Address, City, XYZ.

Early in the 20XX tax year the organization decided to become inactive and communicated this to its clients and made them seek Counseling / Debt Management Plans else ware. Later that year the organization was approached by President which resulted in the purchased the organization's shell / tax exempt status. On November 28, 20XX new management filed articles of amendment with the State of XYZ which removed all of the old officers and directors and add new officers and directors.

The President of ORG, President is also the President of CO-1 another ORG organization. CO-1 was examined by Revenue Agent RA and resulted in the revocation of the organization's IRC, section 501(c)(3) tax exempt status for insubstantial exempt activities.

ORG has no publicly listed phone number or website for potential clients to contact the organization. The organization receives the majority of its clients from CO-1. CO-1 brings the client in the door and acquires all of the financial information from prospective clients, helps them with their budget and what ever other counseling that organization does. If it is determined that a client does not qualify for a debt management plan, CO-1 then gives the client as one of their options a chance to sign up for a debt settlement which are administered by ORG. ORG was set up by President to handle only debt settlement plans which is the organization's substantial activity. Debt settlements plan were explained that the client makes regular monthly payment which are held in trust until enough money is accumulated to give all of their creditors and option to receive a lump

sum payment to settle all outstanding debt the client has with them. The amount offered is always less then the amount owed and the creditor has the right to accept the offer, reject the offer or make a counter offer. The two major factors which make clients want to sign up for a debt settlement plan are that their creditors are notified of the plan and this stops collections phone calls to the client and the clients can make a monthly affordable payment which will allow them to eventually get out of debt, by paying an amount which is less then what is owed. Agent discovered form the review of the books and records that the organization also purchases prospective client list and acquires new clients from that list also, but most of the client are referred by CO-1

The organization was correctly given it tax exempt status based on the educational activities described in the Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. However, ORG's current activities offer very little education, if any at all, to its clients or the public. By the time it is determined by CO-1 that the client does not qualify for a debt management plan the education received by the client is pretty much completed. When a client signs up for a debt settlement plan with ORG, only the amount of the monthly payment and monthly fees charged need to be determined. These amounts are written into a contract to make the debt settlement plan a legal document. The organizations offer its client the same services as a for profit ORG organization and charges comparable fees for the same services provided. The organization does not limit it client base to an exempt charitable low income population but offers their services to who ever needs and is willing to pay for them. The organization is motivated by the fees that it charges and not by charitable activities described in IRC, section 501(c)(3).

LAW and ANALYSIS:

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

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

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

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities

that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945).

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

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

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

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the "est" body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments

made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations."

The Service has issued two rulings holding credit counseling organizations to be tax exempt. Rev. Rul. 65-299, 1965-2 C.B. 165, granted exemption to a 501(c)(4) organization whose purpose was to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been meeting with people in financial difficulties to "analyze the specific problems involved and counsel on the payment of their debts." The organization also advised applicants on proration and payment of debts, negotiated with creditors and set up debt repayment plans. It did not restrict its services to the needy. It made no charge for the counseling services, indicating they were separate from the debt repayment arrangements. It made "a nominal charge" for monthly prorating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions.

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

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were "an integral part" of the agencies' counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies' principal functions, as only approximately 12 percent of the counselors' time was applied to debt management programs and the charge for the service was "nominal." The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

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

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free marriage counseling); Rev. Rul. 68-71, 1968-1 C.B.249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." The words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. § 1.501(a)-1(c). 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. 1999). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

Where an organization provided a source of credit to companies of which a private shareholder was either an employee or an owner, the court found that a portion of the organization's net earnings inured to the benefit of that private shareholder. Easter House v. United States, 12 Cl. Ct. 476 (1987). That such loans were made showed that the companies controlled by the private shareholder had a "source of loan credit" in the organization.

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

The CROA defines a credit repair organization as:

> (A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform)

any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—

(i) improving any consumer's credit record, credit history, or credit rating, or

(ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

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

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

GOVERNMENT POSITION:

ORG does not meet the operational test, because more than an insubstantial part of its activities are commercial in nature. By definition, IRC section 501(c)(3)organizations will only qualify for tax exempt status if it is organized and operated exclusively for charitable purposes. Thus, to meet the requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests. ORG is operating in a commercial manner which is not an exempt activity described under Internal Revenue Code section 501(c)(3).

An organization may meet the requirements of section 501(c)(3), although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. An organization, which is organized and operated for the primary purpose of carrying on an unrelated trade or business, is not exempt under section 501(c)(3).

The purpose of ORG's activities differs substantially from those of the organizations in Rev. Rul. 65-299, Rev. Rul. 69-441, and Consumer Credit Counseling Service of Alabama, Inc. v. U.S. ORG was never an entity that stood on its own or conducted activities. During the period of exam, ORG engaged in no separate activities which furthered an exempt purpose. There were no fees waived, public support, educational program, or any exempt activity that would meet the requirements as

stated under IRC section 501(c)(3). There was no evidence of any meaningful education or ORG being conducted. Unlike the Credit Counseling organizations described in the Revenue Rulings referred to above, and in Consumer Credit Counseling Service of Alabama, Inc. v. U.S., during the period of exam ORG provided very little if any counseling or education to its clients. ORG sole purpose was to manage debt settlement plans for clients that did not qualify for debt management plans with CO-1

The ORG operations during this period, met none of the requirements to be exempt. 100% of the funds received were from debt settlement plans or fair share payments.

Credit Repair Organizations Act (CROA) was enacted to protect consumers by banning certain deceptive practices in the Credit Counseling industry. If ORG was a for-profit company, the CROA would prohibit it from charging fees in advance of fully providing services. In addition, if ORG were for-profit, federal law would prohibit it from purchasing leads and making cold calls to potential customers. Because section 501(c)(3) organizations are exempted from the provisions of CROA, ORG is able to engage in deceptive business practices that Congress intended to prohibit when it passed CROA. As such, ORG is operated for a substantial non-exempt purpose--that of carrying on a business while avoiding certain federal regulations. In addition ORG could not collect "fair share" payments from creditors if it did not have exempt status. ORG was formed for the private benefit of its principals. Substantially all operations were performed as a for-profit corporation.

ORG Position on Revocation

The organization agreed to the revocation of its tax exempt status before Agent started the case. Manager met with the taxpayer for the examination of CO-1 and at that meeting they agreed that the organization did not qualify for exemption. Agent has hand delivered a Form 6018 and is waiting for it to be signed.

Response to Taxpayer Position on Tax Assessment

Agent agrees with the taxpayer that the organization lack substantial exempt activities and that their IRC, section 501(c)(3) tax exempt status should be revoked.

Conclusion

Based on ORG conduct in this examination process and our determination that you do not operate exclusively for exempt purposes, because you do not engage primarily in activities that accomplish an exempt purpose, you are found not to be exempt from Federal Income Tax. Your activities in light of the applicable law confirm that you are not organized nor are you operated for exempt purposes. Your principal activity is the management of debt settlement plans. This activity does not achieve charitable or educational purposes, but is merely a commercial service. Even if you were able to establish that you were formed and operated for charitable or educational purposes, you would not qualify for exemption because you are operated for a substantial non-exempt

purpose. ORG is operated for the purpose of serving a private benefit rather than public interests. Accordingly, it is determined that ORG, is revoked because it is not an organization described in IRC, section 501(c)(3), and exempt from income tax under section 501, effective January 1, 20XX.