INTERNAL REVENUE SERVICE

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TE/GE TECHNICAL ADVICE MEMORANDUM

Area Director, Area 4 TEGE Appeals
Philadelphia, PA

NOV 2 2 2013

UIL Code: 501.03-30

Taxpayer's Name: **********

Taxpayer's Address: **********
****

Taxpayer's ID No.: **********

Year(s) Involved: **********

Conference Held: **********

LEGEND:

Taxpayer = **********

ISSUE:

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

FACTS:

Application for Exemption
The Taxpayer, a non-profit corporation, was recognized as exempt under § 501(c)(3). Its Articles of Incorporation provided that Taxpayer was organized for the following purposes:

- To provide family credit counseling services for members of the public and to advise persons seeking credit, budget, or financial advice;
- To seek the cooperation of merchants, lending institutions, banks, and others—individually and through their associations, public officials, and offices;
- To promote budgeting, thrift, and the protection of individuals and families emphasizing consumer credit;
- To conduct research projects, advertising, public relation activities and other activities with respect to budgeting, financial matters, and consumer credit;

- To engage in educational pursuits that assists individuals or families in life management skills.

Taxpayer stated it would engage in the following activities:

> (1) Giving charitable advice to poor, underprivileged, and financially distressed members of the community to help the poor and their families get out of debt and stay out of debt.
> (2) Doing charitable work for the poor, underprivileged, and financially distressed members of the community by contacting their creditors for them, rescheduling their payments, helping them complete forms or completing forms for them, and writing letters for them to help them get out of, reduce, and stay out of debt.
> (3) Lessening the burdens of state and federal government by helping poor, underprivileged or financially distressed members of the community from having to seek and rely upon state or federal financial aid in order to feed, house, or support themselves or their families.
> (4) Educating the poor, underprivileged, or financially distressed members of the community on how to set up and live within budgets that they can afford so as to avoid getting into debt and behind in their payments to their creditors.
> (5) Lessening neighborhood tensions by helping poor, underprivileged, and financially distressed members of the community from having to [declare] bankruptcy, become homeless, and resorting to possible criminal activities to take money to survive.
> (6) Combating community deterioration and juvenile delinquency by helping parents get out of debt and stay out of debt, support themselves through their own labor and provide safer, more secure homes for their children.

Taxpayer further stated that all activities would be initiated by members of the community who contacted Taxpayer for assistance and would be conducted at its office. Taxpayer stated it would meet people face-to-face, gather an individual's or family's credit card statements, and analyze their income and expenses. Moreover, based on the criteria of each of their creditors, Taxpayer would help them establish a budget and manage their debt by making a single monthly payment to the creditors through Taxpayer. When Taxpayer would receive those payments, it would then distribute the payment among the creditors. Taxpayer stated that credit counseling services would be available to anyone who wished to participate in the program.

Taxpayer indicated that its sole source of income would be gifts, grants, and contributions. It also stated that 50 percent of its financial support would come from contributions from the general public and 50 percent from private organizations. Taxpayer stated that its consultation, analysis, and budget planning would be free to the community. If persons or families further wished to use Taxpayer's services, upon

enrollment in the debt management program, they would be advised to make a voluntary contribution to Taxpayer. Persons who enrolled and continued to use Taxpayer's services would be advised to make a voluntary contribution for every monthly payment they made through Taxpayer. Moreover, Taxpayer answered in the negative to the question: If the organization provides benefits, services, or products, are the recipients required, or will they be required, to pay for them?

Taxpayer listed three members on its governing body, two of whom were husband and wife. Taxpayer stated that the husband and wife trustees would conduct all Taxpayer's activities.

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

Examination

The examination concluded that Taxpayer did not provide any education or counseling tailored to the needs of the individuals. The exam agent found that Taxpayer did not document any referrals to professional outside help, or keep any records of client education or counseling. Taxpayer's only educational materials appeared on its website after April of the first exam year, and were limited to budgeting tools, links to outside resources, and information on DMPs. The only files Taxpayer kept were those of DMP clients, containing DMP contracts and credit card statements. However, Taxpayer failed to keep files in which it provides education to clients. Taxpayer stated that the reason it keeps only files on DMP-enrolled clients is that it would be too costly to keep files on everyone who called. The Taxpayer maintained that it conducted face-to-face counseling and seminars, but failed to provide documentation that it did so. The examination found that Taxpayer's primary activities were selling and managing debt management plan (DMP) accounts. It maintained between 800 and 850 DMPs at any given time, with 100 percent of its income derived from selling and managing the DMPs. Its website generates DMP leads. Thus, Taxpayer did not conduct its activities exclusively in a manner that furthers a tax-exempt purpose.

The examination also found that a fourth trustee was on the board of directors; however, Taxpayer did not list him in the Form 1023 application. The trustee was also related through a familial relationship. The fourth trustee was Taxpayer's president who stated he had not listed himself as an officer on the Form 1023 because he planned to receive a full-time salary and believed that paid officers would be looked upon unfavorably. President was in charge of daily operations, performed all substantive work, and hired minimal clerical help. President was the only credit counselor but had no certifications or degrees in credit counseling, counseling, or social work, although Taxpayer's website and telephone answering service asked prospective clients to "speak with [Taxpayer's] certified counselors . . . ." President stated that he acquired general knowledge about credit counseling and DMPs from a friend. President created Taxpayer's website and wrote all the information contained on the website.

The examination concluded that Taxpayer's primary activity of enrolling and managing the debt accounts of clients in DMPs generated all of Taxpayer's income. Taxpayer distributed a client's DMP payment minus a "voluntary" contribution to each creditor under the terms of the DMP. During the examination period, Taxpayer did not receive any public or private contributions. Taxpayer's revenue was derived from either its DMP clients or from the banks to which it provided DMP payments (fair share payments). Taxpayer was unable to furnish any documentation that DMP fees charged to clients were voluntary, and was also unable to provide any documentation that Taxpayer waived any of the fees.

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

LEGAL STANDARD:

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

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

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

Section 4.04 of Rev. Proc. 2013-5, 2013-1 I.R.B.170, states that all requests for relief under § 7805(b) must be made through a request for technical advice (TAM). Section 19.04 states further that when, during the course of an examination by EO Examinations or consideration by the Appeals Area Director, a taxpayer is informed of a proposed revocation, a request to limit the retroactive application of the revocation must itself be made in the form of a TAM and should discuss the items listed in § 18.06 of Rev. Proc. 2013-5, as they relate to the taxpayer's situation.

Section 18 of Rev. Proc. 2013-5 lists the criteria necessary for granting § 7805(b) relief as well as the effect of such relief. Section 18.06 states, in part, that a TAM that revokes a determination letter is not applied retroactively if:

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

Rev. Proc. 2013-9, 2013-2 I.R.B. 255, sets forth procedures for issuing determination letters (from EO Determinations) and rulings (on applications for recognition of exempt status by EO Technical) on the exempt status of organizations under § 501. These procedures also apply to revocation or modification of determination letters or rulings.

Section 12.01 of Rev. Proc. 2013-9 states, in part, that the revocation or modification of a determination letter or ruling recognizing exemption may be retroactive if the organization omitted or misstated a material fact, or operated in a manner materially different from that originally represented. In certain cases an organization may seek relief from retroactive revocation or modification of a determination or ruling under § 7805(b) of the Code using the procedures set forth in Rev. Proc. 2013-4, 2013-1 I.R.B. 126, which further refers to Rev. Proc. 2013-5, §§ 18 and 19.

Section 12.01(1) of Rev. Proc. 2013-9 states that where there is a material change inconsistent with exemption in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change.

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

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

In Variety Club Tent No. 6 Charities, Inc. v. Commissioner, 74 T.C.M. (CCH) 1485 (1997), the court held that petitioner "operated in a manner materially different from that originally represented." The organization represented in its exemption application and articles of incorporation that no part of its net income would inure to the benefit of any private shareholder or individual. But the court found instances of inurement over several years, and upheld the Service's retroactive revocation for such years.

ANALYSIS:

During the years under exam, Taxpayer's operations were materially different from the description it provided in its exemption application. See Variety Club Tent No. 6 Charities, 74 T.C.M. at 1485; Rev. Proc. 2013-9 at § 12.01. Taxpayer claimed on its Form 1023 that it would educate the poor, underprivileged, or financially distressed members of the community on budgeting, consumer finance, and credit, as well as promote such education. The examination found that Taxpayer devoted nearly all of its time and resources to selling and servicing DMP accounts. Thus, Taxpayer did not conduct its activities exclusively in a manner that furthers a tax-exempt purpose. Taxpayer also claimed on its Form 1023 that its income was from gifts, grants, and contributions from the general public and private organizations. It further stated that, if the consumer wanted to take advantage of a DMP, the consumer was advised to make a voluntary contribution(s). However, the examination revealed that the charitable contributions were actually fair share payments, and the payments the Taxpayer initially characterized as voluntary contributions from individuals enrolled in DMPs were fees for services. Taxpayer maintained in the Form 1023 that, if it provides benefits, services, or products, the recipients would not be required to pay for them. However, Taxpayer was unable to furnish any documentation that DMP fees charged to clients were voluntary. It was also unable to provide any documentation that Taxpayer waived any of the fees. Finally, Taxpayer admitted to the examination agent that it had purposefully omitted from its Form 1023 application the existence of an additional, related trustee who also served as president and as the only full-time employee. Taxpayer's president stated he had not listed himself as an officer on the Form 1023 because he planned to receive a full-time salary and believed that paid officers would be looked upon unfavorably. Thus, Taxpayer did not fully apprise the Service of the material changes in its operations. See Stevens Bros. Foundation, 324 F.2d at 641 (failure to adequately and sufficiently inform the Service of material changes in operations).

Therefore, revocation may be retroactive to the first year under examination, when the Service determined Taxpayer had made material changes in its operations. See Automobile Club of Michigan, 353 U.S. at 184 (Commissioner has broad discretion to revoke a ruling retroactively); Rev. Proc. 2013-9 at § 12.01(1) (revocation ordinarily applies as of the date of material changes in operations.)

CONCLUSION:

The Commissioner, TEGE, has declined to exercise discretion to limit the retroactive effect of revocation of exempt status under § 501(c)(3). Revocation shall be effective as of the first day of the first tax year under exam.