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INTERNAL REVENUE SERVICE

TE/GE TECHNICAL ADVICE MEMORANDUM

Area Director, Area 4 TEGE Appeals

UIL Code: 501.03-00

Date: November 15, 2013

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

FACTS:

Application for Exemption

Taxpayer applied for tax-exempt status, describing its activities on the Form 1023. Taxpayer stated in its Articles of Incorporation that it would "be helping the community who needs financial help enter a debt management program that will help them out of debt and educate them." Taxpayer stated that it would educate the community about credit and how to use it effectively, including education on credit cards, loans, financial lenders, homes, and other available credit. It would offer classes, brochures, and other educational material to clients. Taxpayer estimated it would spend 20 percent of its time and resources on these activities.

Taxpayer estimated it would spend 40 percent of its time and resources to solicit customers to enter its debt management program to help clients reduce their interest, lower their monthly payment, and help them get out of debt within 36 to 48 months. Taxpayer stated it would advertise in the media, through brochures, and word of mouth.

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Taxpayer also estimated it would spend 20 percent of its time and resources processing contracts by writing proposal letters to creditors so that the customers could receive the benefits of reduced interest and payments. An outside processor would handle these contracts. Finally, Taxpayer estimated it would spend 30 percent of its time and resources to continually service these clients to ensure they were receiving the benefits of, and continue in, the debt management plan (DMP) program. There would be a quarterly review for each client and a bimonthly call to ensure customer satisfaction. Collectively, Taxpayer would spend about 90% of its time and resources on these activities.[1]

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

Examination

The examination concluded that Taxpayer all but eliminated any education it had proposed to provide to the community and its clients. It did not conduct any seminars or workshops during the first audit year, nor did it send newsletters to its clients during the second audit year. Its television advertisements were for its DMP program. It failed to produce any records evidencing that it provided its customers with any educational materials. Taxpayer also failed to produce records that it conducted any educational follow up with its clients. Taxpayer only spent 2.82 percent of its resources on educational activities. It spent nearly all its time soliciting, enrolling, and servicing customers in its DMP program, and did not counsel individuals or families about personal finance, budgeting, or credit. The examination also found that Taxpayer substantially engaged in selling and purchasing DMP accounts to and from a third-party for-profit corporation. Taxpayer did not report these changes in operation to the Service.

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

LEGAL STANDARD:

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

Section 1.501(a)-1(a)(2) of the Income Tax Regulations states that an organization that has been determined by the Commissioner to be exempt under § 501(a) may rely upon such determination so long as there are no substantial changes in the organization's

[1] Taxpayer estimated it would spend 20 percent on educational activities, and 90 percent on soliciting, enrolling, and servicing customers in its DMP program.

character, purposes, or methods of operation, and subject to the Commissioner's inherent power to revoke rulings because of a change in the law or regulations, or for other good cause.

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

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 request for a TAM and should discuss the items listed in § 18.06 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) 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, purpose, or 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 Form 1023 exemption application. See Variety Club Tent No. 6 Charities, 74 T.C.M. 1485; Rev. Proc. 2013-9 at § 12.01; Rev. Proc. 2013-5 at § 18.06 (no misstatement or omission of material facts or materially different facts). Taxpayer claimed on its Form 1023 that it would spend about 20 percent of its time and resources providing educational services to its clients and the community. However, the examination revealed that it all but eliminated the educational program it had described on its Form 1023. It made only de minimis expenditures for educational activities, did not conduct seminars or send newsletters to its clients, and failed to provide data or evidence that it provided its clients or the community with educational materials. Therefore, Taxpayer did not provide counseling or educational information to its clients or the general public on budgeting, personal finance, financial literacy, saving and spending practices, or the sound use of consumer credit. It also sold and purchased significant numbers of DMP accounts to and from a third party for-profit company; therefore, it processed DMPs originated by a third party for-profit company and did not itself tailor them to the specific needs and circumstances of the clients. Taxpayer did not apprise the Service of these 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 Taxpayer's exempt status under § 501(c)(3). Revocation is effective as of the first day of the first tax year under exam.