DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date:

JUL 07 2004

Contact Person:

Telephone Number:

Fax Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information you submitted under the penalties of perjury, we conclude that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

Facts:

You are organized as a corporation under law. Your Articles of Organization were filed Article II provides, in part:

> The purpose of the corporation is to engage in the following activities: The Corporation is organized exclusively for charitable, educational and scientific purposes, to include providing educational services, program and research, to the public use of consumer credit; engaging in non-profit credit counseling services including, but not limited to, the individuals in connection with the creation of budgetary plans whereby an individual turns over an agreed amount of his income which distributes it, with a charge to the individual, to his creditors in accordance with an approved budgetary plan.

The application (Form 1023) was submitted by your president, . The application states the following, which appear to be individual activities rather than your activities:

- Currently employed as a Certified Credit Counselor since .
- Provide counseling through personal contact since .
- Passed test given by Associations in Counseling giving me the Certified Credit Counseling status .
- Give seminars, free of charge, to groups in churches, schools, home mortgager ....

[redacted]

- Since [redacted], have shown people how to save money through budgeting.
- When I start my own business in [redacted], I will provide the exact same services as I have since [redacted], but better service is my goal.

According to his resume, [redacted] was employed as a certified credit counselor with [redacted] of [redacted], from [redacted] to [redacted]. The resume states:

> I performed two functions as an employee of [redacted]. As an hourly employee, I advised incoming telephone callers as to the benefits of the over-all credit counseling program and whether or not the [redacted] approach would help them reach their financial goals. As a sub-contractor, I acquired clients in the [redacted] area and received a monthly commission while these clients remain in the program.

[redacted] was also an independent contractor for [redacted] and [redacted]) prior to your formation. Both [redacted] and [redacted] were charged by the Federal Trade Commission with engaging in fraudulent credit repair activities and agreed to pay more than $[redacted] million in consumer redress in [redacted]. The final settlement also enjoins any further violations of the FTC Act and the Credit Repair Organizations Act. A detailed notice of the terms of the settlement was provided to the defendants' national network of sales representatives who were barred from continuing misrepresentations regarding the computer disk and software program. The order required each of the sales representatives to sign and return a form acknowledging receipt of the notice. See Federal Trade Commission Press Release, August 11, 2003, (copy enclosed.)

In response to our request for additional information regarding your continued association with the [redacted] network, your letter dated [redacted], states:

> [redacted] is no longer associated with [redacted] or [redacted]. [redacted] has not performed an application for credit repair since [redacted] of [redacted]. [redacted] notified [redacted] in [redacted] of [redacted] that he would no longer perform as a Credit Repair Representative.

As of [redacted], the URL "[redacted]" is the address of an active Web site for the organization [redacted]. The company is also designated as [redacted] According to information found on its Web site, [redacted] offers financial counseling and credit restoration. It states that "[redacted] can successfully remove inaccurate outdated, or improperly reported negative entries from credit reports." [redacted] offers a "110% money back guarantee if your credit report does not improve within 1 year" and appears to be the same organization as [redacted]. A copy of an active [redacted] Representative's Web site (copy enclosed) contains identical language. [redacted] shares the same suite of offices and the same telephone number as you. (Copies of Web pages are attached for your convenience.)

[redacted]

It is stated in your application that "I have no solicitations for financial support in process." The application indicates a charge for credit counseling services: "Initial $[redacted] application fee and a $[redacted] per account fee to manage debt over term of payments."

In a letter dated [redacted] you state that "this organization will be organized exclusively for the exempt purposes of helping client to pay their debt to their creditors in a shorter period of time than they could do for themselves." With respect to fees charged for such services, you state: "the fees are determined as fees that are currently acceptable by many states with laws in this area. Many of the companies that are certified have similar cost structures. Our goal is to apply the least fees in the industry towards our program."

In your letter dated [redacted], you state:

> Our plan is to use the yellow pages and the Internet, but primarily word of mouth through our free education services to promote the [redacted] to new possible clients....
>
> Our customer contact will begin by our client contacting us through an educational seminar, the phone or Internet. We will explain what we can and cannot do for our clients. If they are still interested, we will set up an appointment to review our client's personal information. At this time, we will educate the client on the possible benefits of the program and how the program works....
>
> It is estimated that it will take our clients approximately 48 to 60 months to finish our [redacted].
>
> Our organization will provide credit counseling to our clients. The current plan is that we will not provide any other type of service for these clients....

Enclosed with your letter dated [redacted], is "additional correspondence to our clients." One of the enclosures, titled "[redacted]" states:

> Upon joining [redacted] each client is automatically assigned to a particular Customer Service Representative.... This representative will be his or her contact throughout the first few months of the program.... [redacted] will send out proposals each month.... Each representative will be responsible for the follow-up and close monitoring of their own client's proposals, and stay in contact with the creditors and clients. This will insure that all proposals are accepted in a timely manner and noted in the system. Each proposal is carefully tracked as far as the date it was sent, the amount it stated, and the date they were returned from the creditors.

In your letter dated [redacted], and signed by [redacted], you state:

[redacted]

I am requesting that you process our status as soon as possible. As you suggested we have started the organization to service clients with the intent of showing what great work we can do. Unfortunately, the creditors have refused to serve our clients without us obtaining the non-profit status. I have attached a copy of a sample letter from the creditors. We have currently frozen taking any new clients on, but are now referring them to other community organizations from the NFCC. (Currently, these community organizations are out of state.) This means that are [sic] clientele is not able to be served in their area and makes the service unaccessible [sic] to them. Especially since the NFCC in the [redacted] Area closed down last year. Also, we have to pass off the clients that we have obtained over the last month unless we are able to receive status very quickly.

Accompanying your letter dated [redacted], is a letter to you from [redacted] which states:

Re: Your Proposal Letter
We are unable to process the enclosed document. At this time it is [redacted] policy to require approved non-profit status before accepting repayment proposals from, or making fair share contributions to, debt management agencies.

Also accompanying your letter dated [redacted], is an undated letter from [redacted] which states:

We are looking to be a non-profit company that helps people reduce their debt and understand how to obtain financial freedom. Our mission is to educate the public in being financially stable to the best of their ability. We need funds to both function as individuals in our daily live[s] and to do our jobs as Certified Credit Counselors. In order to reach that goal we feel that we need to work to the following pay formula:

A. $[redacted], one-time fee for processing of the application. Processing entails employees to input the budget into the computer, use paper to print the budget, mail envelopes and stamps to send budget to clients, payments and proposals to creditors....

After the creditor accepts the proposal, we receive a fair share in the form of different percentages as it pertains to the clients' payments. If one client makes a payment through us to a creditor of $[redacted] and the creditor offers a [redacted]% fair share payment we would get $[redacted] for this client. Thus, if you have more clients you receive more pay from each creditor.... It is estimated that an average client base of [redacted] clients will net approximately $[redacted] net profit before employee expense.

[redacted]

You have provided a manual titled "Operating Policies" with "effective date [redacted]". The opening paragraph of the manual reads:

> [redacted] ... is a community service organization to provide confidential budgeting and debt management counseling, education in money management, budgeting, and the wise use of credit.

The manual contains the following information under the heading "debt management":

> Our agency will establish debt management programs when in the best interest of the client....
>
> Our agency currently charges an application fee for the debt management program not to exceed $[redacted]. Our monthly maintenance fees will be $[redacted] per account, not to exceed $[redacted] per month.... No one will be denied service because of inability to pay this fee: in hardship cases it can be reduced or waived entirely by staff.
>
> Our agency, to ensure a timely debt satisfaction program and to prevent negative amortization, shall establish plans with approximately 60 months. Unfortunately, with creditor interest rates rising dramatically in the last couple of years, it becomes more impossible for clients to complete the program less than 60 months, but when it dramatically exceeds 60 months our client will need the approval of management. Only in rare circumstances (benefit to client) will we take a client over 60 months.
>
> In most cases, our agency will require that all unpaid credit with the exception of mortgages and autos be administered through the debt repayment program.... Our agency will provide to disbursing clients a statement indicating client payments received, and itemizing dollars disbursed to each creditor.
>
> Our agency will provide information to creditors concerning the debt repayment program and the client's information to ensure acceptance of the payment proposal....
>
> Our agency shall not offer financial incentives to counselors solely based on establishing clients in the debt management programs; nor shall counselors be penalized financially when clients take over their own debt repayment or are unable to continue with their programs....

Under the heading "Client Fees," the Operating Policies manual provides the following information:

[redacted]

Counseling Fee: No counseling fee will be charged. Clients will have the opportunity to meet with their counselors without any fee ever being charged.

DMP Enrollment Fee: A one-time enrollment fee of $[redacted] will be charged for each DMP, which may be waived or adjusted for financial hardship at the discretion of the financial counseling staff.... Staff will only follow up minimally with clients who do not mail in the enrollment fees.

Debt Management Program (DMP) Maintenance Monthly Fee: A maintenance fee of $[redacted] per account per month will be charged for all DMPs. However, there will be a minimum fee of $[redacted] per month and a maximum fee of $[redacted] per month.

With regard to "Fundraising," the Operating Policies manual states: "[redacted] does not engage in fund-raising activities and has no plans on doing so at this time."

In a letter dated [redacted], you state:

Most of [redacted] time is geared to educational activities. The complete credit counseling service (if provided well) is all educational. Starting with answering phone calls and explaining what credit counseling is and what we can and cannot do for a client. It is then followed up with counseling sessions on setting up a budget and learning budgeting skills....

We plan to do as many speaking engagements that are physically possible. When you do speaking engagements it is our primary way of obtaining new clients. Individuals that are interested obtain our business cards and then set up individual appointments with us.

An attachment to the [redacted], letter is titled "Consumer Guide." Under the heading "Service Provided," it reads:

The Debt Management Program offered by [redacted] is designed to help you get back on track and out of debt. We can help guide you to a household budget you can live with while implementing repayment plans with your creditors.

The Consumer Guide states the following "About [redacted]":

[redacted] is a[n] organization offering confidential debt counseling and education to consumers.... [redacted] works with the credit card industry to achieve its goals in the most cost effective way for all parties. Most of the funding for our services comes from voluntary contributions by creditors which enables [redacted] to charge consumers nominal enrollment and maintenance fees....

[redacted]

Under the heading "[redacted] Enrollment Process," the Consumer Guide states:

> 1. Each client will participate in a confidential interview and counseling session with an [redacted] Certified Credit Counselor. Once it is determined that enrollment in [redacted]'s Debt Management Program is the right course of action for the client, the counselor or client services representative will assist in the completion of the paperwork necessary to initiate the budget process....
>
> *** ***
>
> 3. Your initial paperwork is reviewed by a certified counselor.... Within seven to ten days ... [redacted] will mail you a formalized budget ... and a breakdown of the proposed payments to your creditors, detailing anticipated adjustments. The summary will indicate the amount of the monthly payment you will need to send to [redacted] by a specific due date each month.
>
> 4. Once you have called to approve your budget ... and you send your first payment, [redacted] will submit proposals to your creditors.... Accepted proposals are recorded promptly, but sometimes creditors either reject or make counter proposals.... If necessary, new proposals and budgets are developed and submitted....

"Attachment 'C'" to the [redacted], letter is titled "Counseling Clients," and contains "scripts to be uses [sic] with counselors." It reads, in part:

> Potential clients are always welcome at our office in [redacted] where we offer financial education in personal meetings at clients' convenient times....
>
> After introducing ourselves, we go through some minor introductory comments and sit down in a professional setting to discuss our reason for meeting.
>
> I listen to the client's reason for meeting. I watch his body language to detect their attitude and level of concern....
>
> The client will then explain their situation. We talk about how much debt they have, what type of problems are causing them to seek help, and how these problems are affecting them and their family....
>
> Guide the client through the process. Looking at their debt is the first step. How can I help them and what should the next step be?
>
> I then look at their income and cost of living analysis. I evaluate their disposable income status. A number of steps are taken from here.

[redacted]

1. If disposable income is negative we look at options to reduce cost of living expenses or increase income.
   a) We look at clothing, miscellaneous, and cable TV expenses particularly.
   b) We look at utility expenses and discuss payment plans with companies that take level monthly payments instead of monthly payments dependant on usage spikes.

2. If disposable income is very negative, I then suggest other options....

3. If the disposable income is positive to a small point and adjustments to income or cost of living can still be accomplished we look at whether our program can help them.

If the unsecured debt is in credit cards, personal loans, or collection status then we look at whether the program will help them. The major question is whether our program will reduce interest rates and monthly payments. If it is a positive situation for the client then we look at finalizing the meeting. I make copies of their statements, and have them sign the Limited Power of Attorney and Contract Agreement. I give the client a copy of each official document and take their processing fee of $[redacted]. I realize that this is a small amount that seals the determination of the client to go through with this program and appreciate the opportunity to reduce their debt in a reasonable time.

4. If disposable income is more than ample, then I look at controlling their debt on their own and using a spend plan that will help them find their way back to controlling their expenses.

"Attachment F" to the [redacted] letter includes a form "Debt Management Contract Agreement" between you and a client and related materials. The agreement provides that, in return for an application fee of $[redacted] and $[redacted] maintenance fee per account per month, you will undertake the following responsibilities:

1. Act as an intermediary between client and client's creditors for the expressed purpose of negotiating a voluntary reduction in monthly payment amounts or interest rates;
2. Prepare a household budget and DMP for client;
3. Collect from client the funds necessary for monthly disbursements to client's creditors and maintain accurate accounting records of all such funds;
4. Disburse monthly payments to client's creditors as scheduled in client's DMP;
5. Provide budget and credit management counseling as appropriate within client's participation in the DMP;
6. Acquire client's credit report when deemed necessary to provide counseling.

A sample client letter contains the following information about your "funding source":

Most of our funding comes from voluntary contribution from creditors who participate in Debt Contract Agreements. Since creditors have a financial interest in getting payments, most are willing to make a contribution to help fund our agency. These contributions are usually calculated as a percentage of payments. Your accounts with your creditors will always be credited with 100% of the amount paid through us and we will work with all creditors regardless of whether they contribute to our agency.

In a letter dated [redacted], you state:

> We will be managing payments of debt management plans on our own. We will not be hiring any other credit counseling service to perform [redacted] payments to creditors....
>
> We feel that 33% of the individuals who seek our services will be put into a debt management plan. We think that 65% of individuals will complete the DMP.

Your proposed budget for [redacted] months beginning [redacted] shows that your sole sources of income are: (1) DMP application fees; (2) DMP account fees; and (3) fair share payments from your clients' creditors. The statement of revenue and expenses accompanying your letter of [redacted], shows revenue from gross investment income and "net income from ... unrelated business activities."

Law:

Section 501(a) of the Internal Revenue Code exempts from federal income taxation organizations described in section 501(c).

Section 501(c)(3) of the Code describes corporations, trusts, and associations organized and operated exclusively for charitable, educational, and other exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax 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(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

(a) Limit the purposes of such organization to one or more exempt purposes; and

[redacted]

(b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization must be organized and operated to serve a public rather than a private interest, and specifically 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.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that 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 purposes of carrying on an unrelated trade or business.

In Rev. Rul. 61-170, 1961-1 C.B. 112, an association composed of professional private duty nurses and practical nurses which supported and operated a nurses' registry primarily to afford greater employment opportunities for its members was not entitled to exemption under section 501(c)(3) of the Code. Although the public received some benefit from the organization's activities, the primary benefit of these activities was to the organization's members.

In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service found that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code. Its Board of Directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

[redacted]

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, which held the funds in a trust account and disbursed the funds on a partial payment basis to the creditors. The organization did not charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid. The organization did not make loans to debtors or negotiate loans on their behalf. Finally, the organization relied upon voluntary contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The Service found that, by aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and beneficial to the community. Thus, the organization was exempt from federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 71-529, 1971-2 C.B. 234, held that a nonprofit organization providing assistance in the management of participating colleges' and universities' endowments or investment funds for a charge substantially below cost qualified for exemption under section 501(c)(3) of the Code. Most of the operating expenses of the organization, including the costs of the services of the investment counselors and the custodian banks, were paid for by grants from independent charitable organizations. The member organizations paid only a nominal fee for the services performed. These fees represented less than 15 percent of the total costs of the operation. By performing these services for a charge substantially below its cost, the organization was performing a charitable activity for purposes of section 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable for purposes of section 501(c)(3) of the Code. "Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable."

Rev. Rul. 76-244, 1976-1 C.B. 155 , held that home delivery of meals to the elderly free or with charges on a sliding scale, depending on recipients' ability to pay, is a charitable purpose.

Rev. Rul. 78-99, 1978-1 C.B. 152, held that the provision of individual and group counseling for widows based on their ability to pay is an educational activity.

Rev. Proc. 90-27, 1990-1 C.B. 514, provides in part that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a

[redacted]

conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere statement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned, and the nature of the contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required.

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 purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In Birmingham Business College, Inc. v. Commissioner, 276 F.2d 476 (5th Cir. 1960), the court denied tax exemption to an organization in part because its net earnings were distributed to its shareholders for their personal benefit. The founder of the organization and his two sisters were the only shareholders; these three and two of their spouses were the organization's trustees. The court found that the organization was operated as a business ultimately producing substantial revenues for its operators.

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

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S. Tax Cas. (CCH) P9660 (DCDC. 1978), the court held that an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational.

The Consumer Credit Counseling Service of Alabama, which has been recognized as exempt under section 501(c)(3), is an umbrella organization made up of numerous credit counseling service agencies. In this case, these 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. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they provided such services free of charge. As an adjunct to the counseling function, they offered a DMP. Approximately 12 percent of a professional counselor's time was applied to the DMP activity as opposed to an educational activity. Moreover, the agencies charged a nominal fee of up to $10 per month for the DMP. This fee was waived in instances when payment of the fee would work a financial hardship.

[redacted]

The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from counseling fees. In 1974, the Service had ruled that each of the agencies constituted organizations described in section 501(c)(3). However, two years later, the Service notified the agencies that it had made a mistake and was reclassifying them under section 501(c)(4). The reasons given by the Service for revocation of section 501(c)(3) were that: (1) the agencies were not organized and operated exclusively for charitable or educational purposes; (2) the debt management service was not limited to low-income individuals or families; and (3) fees were charged for the services rendered.

The court did not agree with the Service and directed verdicts for the plaintiff. Providing information regarding the sound use of consumer credit is charitable because it advances and promotes education and social welfare. These programs were also educational because they instructed the public on subjects useful to the individual and beneficial to the community. The counseling assistance programs were likewise charitable and educational in nature. Because the community education and counseling assistance programs were the agencies' primary activities, the agencies were organized and operated for charitable and educational purposes. The court also concluded that the limited debt management services were an integral part of the agencies' counseling function, and thus were charitable and educational undertakings, but stated further that even if this were not the case, these activities were incidental to the agencies' principal functions.

Finally, the court found that the law did not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under section 501(c)(3). Nonetheless, the agencies did not charge a fee for the programs that constituted their principal activities. A fee may be charged for a service that was an incidental part of an agency's function, but even when a fee was so charged, it was nominal. Moreover, even this nominal fee was waived when payment would work a financial hardship. Thus, the court ordered that "each of the plaintiff consumer credit counseling agencies was an organization described in section 501(c)(3) as a charitable and educational organization." See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.Tax Cas. (CCH) P9468 (DCDC 1979), in which the facts were virtually identical and the law was identical to those in Consumer Credit Counseling Service of Alabama, Inc. v. United States, discussed immediately above. Thus, the court ordered that the consumer credit counseling agencies were described in section 501(c)(3) as charitable and educational organizations.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. There is nothing inherently charitable in providing consulting services.

The court found that the corporation failed to demonstrate that its services were not in competition with commercial businesses. The court relied on the fact that the organization's

[redacted]

financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs, and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation had failed to limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In St. Louis Science Fiction Ltd. v. Commissioner, T.C. Memo 1985-162, April 2, 1985, the court reviewed the annual convention of a science fiction organization. It held that while the conventions may have provided some educational benefit to some of the individuals involved, that social and recreational activities and private benefit predominated. The court distinguished Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980) in which the organization provided public art education by using juries to insure artistic quality and integrity.

> Petitioner relies heavily upon Goldsboro Art League v. Commissioner, 75 T.C. 337 (1980) in support of the contention that it is tax-exempt. In Goldsboro Art League, the taxpayer was an organization that operated two art galleries that exhibited and sold artworks. We held that the taxpayer was tax-exempt under section 501(c)(3) because it was organized and operated exclusively for an exempt purpose--art education. We noted that in order to insure artistic quality and integrity, the artworks displayed were selected by jury procedures. We also noted that the taxpayer was the only such museum or gallery within its county, or any contiguous county. We held that it served public, rather than private interests and that its sales activities were incidental to advancing its exempt purpose. By contrast, petitioner in this case did not apply any controls to insure the quality of the books and artworks sold at its convention. Also, the tone of petitioner's convention is substantially, if not predominantly, social and recreational, rather than educational. In addition, petitioner's huckster's room and art auction provided substantial benefit to private interests that is not incidental to its exempt purpose. Consequently, we think the case Goldsboro Art League is clearly distinguishable on its facts from the instant case.

Q? Is the education more than incidental to the DMP?

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), *aff'g* 12 Cl.Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the adoption activity was a non-exempt commercial purpose. It found that the adoption services did not further the exempt purposes of providing educational and charitable services to the unwed mothers and children. Rather, the services for unwed mothers and children were merely provided "incident" to the organization's adoption service business. Moreover, the court found that "adoption services do not in and of themselves constitute an exempt purpose."

The court also agreed with the IRS' determination that the agency operated in a manner not "distinguishable from a commercial adoption agency" because it lacked the traditional attributes of a charity. First, the agency's operation made substantial profits, and there was a substantial accumulation of capital surplus in comparison to direct expenditures by the agency

[redacted]

for charitable and educational purposes. Second, the agency's operation was funded completely by substantial fixed fees charged adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. In fact, the agency had no plans, nor intention to seek contributions, government grants or engage in fund raising relative to its operations. Third, the fixed fees the agency charged adoptive parents were not subject to downward adjustment to meet potential adoptive parents' income or ability to pay. Fourth, the agency's single life member had near total control of the operations of the agency. And fifth, the agency functioned by means of a paid staff of 15 to 20 persons, with no volunteer help.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (DCDC 2003), the court concluded that an alleged exempt organization was operated for a substantial non-exempt purpose. It based this conclusion on the manner in which the organization conducted the operation of its conference center. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia*, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations." Thus, the court looked at the business methods of the organization as a way to infer whether its purpose was to serve the public or whether there was a substantial non-exempt purpose of operating a business for profit. See section 1.501(c)(3)-1(e) of the regulations.

In Credit Counseling Centers v. S. Portland, 814 A.2d 458 (Sup. Ct. Me. 2002), the Supreme Court of Maine denied state tax exemption to a credit counseling agency that provided significant benefits to creditors. Credit card companies commonly make payments to credit counseling agencies of a portion of the funds they receive from clients of the agencies. These payments are known as "fair share" payments and are a source of substantial funding for credit counseling agencies. In this case, the credit counseling agency received 60 percent of its income from "fair share" payments from credit card companies, at the rate of 8.5% to 9% of debt payments.

The Credit Repair Organizations Act ("CROA"), 15 U.S.C. section 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. section 1679b. Section 501(c)(3) organizations are by definition 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).

[redacted]

15 U.S.C. section 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).

In FTC v. Gill, 265 F.3d 944 (9th Cir. 2001), aff'g 183 F. Supp. 2d 1171 (2001), the court inferred that a credit repair organization that first promised a "free consultation," but charged fees in advance of the full performance of services was being operated as a charity primarily for purposes of evading regulation under the CROA.

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. Nonprofit organizations are not subject to this rule. This registry was created by rules promulgated by the FTC and the Federal Communications Commission. See 16 C.F.R. section 310.4(b)(1)(iii)(B); 47 C.F.R. section 64.1200(c)(2).

Discussion:

An organization cannot be recognized as exempt under section 501(c)(3) of the Code unless it shows that it is organized and operated exclusively for charitable, educational, or other exempt purposes. Among other things, the application and supporting documentation must demonstrate conclusively that the organization meets the operational test of section 1.501(c)(3)-1(c) of the regulations.

To meet the operational test of section 1.501(c)(3)-1(c)(1) of the regulations, you must show that you engage primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3) of the Code. Exempt purposes include charitable and educational purposes among others.

An activity that purports to further an exempt purpose must be conducted so as to serve public interests rather than private interests. In many cases, an activity may serve both public and private interests simultaneously. However, if the activity serves private interests more than insubstantially, it is not considered to further an exempt purpose.

Consumer credit counseling is an activity that may serve a public interest, a private interest, or both, depending on how it is conducted. An organization whose primary activity is consumer credit counseling does not qualify for exemption under section 501(c)(3) of the Code unless it can demonstrate that its conduct of the activity serves a public interest and any benefit to private interests is insubstantial.

Based on the information you provided in your application and subsequent correspondence, we conclude that your activities constitute a commercial business that substantially serves private interests.

[redacted]

In your letter of [redacted], you state that you will be "organized exclusively for the exempt purposes of helping client to pay their debt to their creditors in a shorter time than they could do for themselves." Your primary activity is the Debt Management Program (DMP). The purpose of the program is to assist each client in paying off the client's consumer debt. You do this by analyzing the client's financial position and debt situation and preparing a payment plan acceptable to the client and the client's creditors. Once the plan is accepted, you collect a specified amount from the client each month, and make payments out of the amount collected to the client's various creditors in accordance with the terms of payment proposals agreed to by client and creditors.

You do not assert, and your application file does not show, that your activities accomplish a charitable purpose. Providing services exclusively for the benefit of the poor, a recognized charitable class, furthers charitable purposes. For instance, counseling the poor about economics and personal finance can achieve an exempt purpose. However, you do not restrict your activities to the benefit of the poor. The DMP you offer is available to anyone who has unsecured debt and is willing to purchase your services. You are unlike the credit counseling organization described in Rev. Rul. 69-441, 1969-2 C.B. 115, supra, which, besides providing information to the public on budgeting and the sound use of credit, operated a debt counseling and management program exclusively for low-income individuals. That organization did not charge a fee for its services, but instead relied upon contributions for support. Thus, its debt management activities accomplished charitable purposes by relieving the poor and distressed.

No court or Service ruling has indicated that the sale of DMPs is a charitable activity. Since the sale of DMPs to the general public appears to be a substantial purpose of yours, we cannot conclude that you are operating exclusively for charitable purposes.

You assert that your activities serve an educational purpose. Following the two-part approach adopted by the Court in American Institute for Economic Research v. United States, supra, we will first assume that your activities have some educational purpose, and then determine if your activities also evidence a commercial purpose.

Factors indicative of a commercial purpose were identified in several of the cases cited above. Those factors include: (1) competition with for-profit commercial entities; (2) whether clients pay for, and receive, a desired service commonly associated with commercial enterprises; (3) the extent and degree of below-cost services; and (4) the extent to which the organization is funded by charitable donations.

Considering these factors, we find that your services have a commercial purpose. First, the services offered through your DMP are similar to services offered by competing for-profit organizations. Second, your clients are paying for, and receiving, a desired service—assistance in paying off their consumer debt through the use of a level payment plan. Finally, your financing does not resemble that of a typical public charity under section 501(c)(3) of the Code. Public charities typically receive substantial revenue in the form of donations from the public and grants from governmental entities and private foundations. In contrast, you do not solicit or receive public support. Your sole revenue is from client fees associated with the DMP and fair share payments from creditors.

[redacted]

In this respect, you are unlike the exempt credit counseling agencies described in Consumer Credit Counseling Service of Alabama, supra. Those agencies received most of their support from government and public foundation grants. Only an incidental amount of their revenue was derived from counseling fees. *See also*, Rev. Rul. 71-529, supra. Instead, you are more like the corporation in B.S.W. Group, Inc. v. Comm'r, whose only source of income was from fees for service. *See also*, Airlie Foundation v. Commissioner, supra. You provide commercially available services for a fee to individuals who are not necessarily poor or distressed. Thus, as was true of the organization described in Rev. Rul. 72-369, supra, your services lack the donative element necessary to establish your DMP as a charitable activity rather than a commercial activity.

Having identified a commercial purpose to your activities, we are left with the question of whether the commercial purpose is primary or only incidental to the exempt purpose. Again, you state that your services serve primarily an educational purpose. You point to the numerous speaking engagements and seminars conducted by your officers. You state that "the complete credit counseling service ... is all educational."

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" means either training an individual to develop his capabilities or instructing the public on subjects useful to the individual and beneficial to the community. Financial counseling could be carried out as an educational activity. *See* Consumer Credit Counseling Service of Alabama and Rev. Rul. 69-441, above. While education is a broad concept, the Service and the courts require that some rigor must be evident. In St. Louis Science Fiction Ltd., supra, the court made it clear, by contrasting the applicant with Goldsboro Art League, supra, that an organization must have a substantial educational program, not a non-educational program with some random educational features.

It appears that the primary purpose of your speaking engagements and seminars is to acquire clients for your DMP programs rather than to educate. For instance, in your letter of [redacted], you state that "our plan is to use the yellow pages and the Internet, but primarily word of mouth through our free educational services to promote the Debt Management Program to new clients.... Our customer contact will begin by our client contacting us through an educational seminar, the phone or Internet." The primary purpose of a seminar is to "explain what we can and cannot do for our clients." In other words, you explain the purpose and operation of the DMP and pass out your business cards. In your letter dated [redacted], you state that "when you do speaking engagement it is our primary way of obtaining new clients. Individuals that are interested obtain our business cards and then set up individual appointments with us." This is a form of "prospecting" or "marketing."

In your own words, the private counseling you conduct consists of explaining to clients "the possible benefits of the [DMP] and how the program works." A counseling session is primarily for determining whether "enrollment in [redacted]'s Debt Management Program is the right course of action for the client." Counseling sessions between your counselors and new or potential clients, while used to impart information about budgeting, are primarily opportunities to assess whether a person could benefit from the DMP, to describe the benefits of the DMP, and explain

[redacted]

the operation of the DMP to the client. If the client agrees to enroll in the DMP, counselors collect information to prepare a formalized budget and payment proposal, and provide the client with the information needed to participate in the DMP. Non-enrollees are provided no services.

Your activities are not at all similar to the activities approved by the court in Consumer Credit Counseling Service of Alabama, supra, in which the debt management program was an incidental part of the organization's total activities and integral to its much more significant educational activities. Rather, the selling of DMPs is your most significant activity. Your seminars and client sessions play an integral part in advertising and promoting the sale of DMPs rather than the education of the general public.

Therefore, we conclude that your educational activities are but an adjunct to, and in the service of, your commercial debt management program. We find that you are similar to the organization described in St. Louis Science Fiction Ltd., supra, in that, while you provide some educational benefit to individuals, your commercial activities on behalf of private individuals predominate.

In your letter of [redacted], you state that "creditors have refused to serve our clients without us obtaining the non-profit status," and that, therefore, "we have currently frozen taking any new clients on" and "we have to pass off the clients that we have obtained over the last month unless we are able to receive status very quickly." It would not be necessary for you to stop taking clients or to pass off clients if you were engaged primarily in activities to educate the public and to counsel clients. Such actions are necessary only if your primary activity is servicing client debts through the DMPs. Educational programs and individual counseling are activities often supported through gifts, grants and contributions from the general public. That you choose to have no fund-raising program to solicit such funds and rely entirely on client fees and fair share payments from creditors is further evidence of your commercial purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirements of this subsection, an organization must 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.

In addition to providing substantial private benefit to your clients, you also provide substantial private benefit to your founder in that you are operated in a manner similar to the nurses' registry described in Rev. Rul. 61-170. One of your substantial purposes is to provide employment opportunities for [redacted] and the other board members. Even if we concluded that the public received some benefit from your activities, the primary benefit of your activities will be to your founder who is a full time employee.

You also provide substantial private benefit to the credit card companies in a manner similar to the organization in Credit Counseling Centers v. S. Portland, supra. Your services benefit the creditors by collecting payments from their debtors that they might not otherwise receive if the debtor were to default or go bankrupt. Creditors show their appreciation by paying

[redacted]

you a "fair share" of the amount you collect from their debtor. Your sample client letter states "most of our funding comes from voluntary contribution[s] from creditors who participate in Debt Contract Agreements. Since creditors have a financial interest in getting payments, most are willing to make a contribution to help fund our agency. These contributions are usually calculated as a percentage of payments." Elsewhere you state "after the creditor accepts the proposal, we receive a fair share in the form of different percentages [of] the clients' payments." Thus, it is apparent that these creditors clearly realize a substantial financial benefit through their business relationship with you.

In addition, you appear to be operating in a manner designed to avoid regulation under the CROA and the Do Not Call Registry laws. CROA imposes restrictions on credit repair organizations, including forbidding advance payment before services are fully performed. As stated above, the courts have interpreted the CROA so as to apply to the activities of credit counseling organizations. The information you provided can only be interpreted as evidence that you charge an advance fee, a practice forbidden to for-profit organizations under the CROA. You provided no information on the frequency of the waiver of such fees or any credible evidence that any clients have received a waiver. Based on the information you have submitted, it appears that one reason you are seeking exemption as an exempt charitable organization is because your activities would not otherwise be permitted a commercial for-profit corporation. In this regard, you are similar to the organization described in FTC v. Gill, supra, in that one of your purposes appears to be evading regulation under the CROA. In addition, your method of seeking clients through telephone solicitations and internet leads would be hindered by the Do Not Call Registry laws.

Because your primary activity, the sale and servicing of DMPs, is a commercial activity that substantially serves the private interests of debtors, creditors, and members of your board of directors, we conclude that you are not operated exclusively for one or more exempt purposes.

Rev. Proc. 90-27, supra, is quite detailed in its requirement for a full explanation of what your organization's activities are before the Service will recognize your exempt status. It requires that the statements submitted in support of your application be truthful.

[redacted] signed the Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code which states:

> I declare under the penalties of perjury that I am authorized to sign this application on behalf of the above organization and that I have examined this application, including the accompanying schedules and attachments, and to the best of my knowledge it is true, correct and complete.

This perjury statement also puts you on notice that Form 1023 and all supporting documentation must be correct.

The information you submitted is contradictory and raises our concern as to whether all of the information you submitted is true, correct and complete. We cannot determine with certainty what you actually do. [redacted] clearly is also having this difficulty. He refers to your activities

[redacted].

as if they are his and vice versa. He describes you as his business venture. You have been able to give us no meaningful assurances that you will be operating as anything other than [redacted]'s commercial business venture.

We are also concerned that you may be a storefront for the commercial debt repair service, [redacted]. [redacted] Web site is still active as of the date of this letter, and shows that [redacted] shares the same office and phone number as you. We note from his resume that [redacted] has been in business for several years as an independent representative for [redacted] and [redacted], a commercial debt repair service advertising as [redacted], although he has stated that he is no longer associated with [redacted].

We conclude further that you do not meet the basic requirements of Rev. Proc. 90-27 because significant information has been submitted in a misleading and contradictory fashion. You have not submitted sufficient probative information to support exemption under section 501(c)(3).

Conclusion:

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

Advantage Independent Credit Counseling Management, Inc.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
TE/GE ([redacted])
[redacted]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

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

Sincerely,

[redacted]
Manager, Exempt Organizations
Technical Group 2

Attachments:
Copies of [redacted] Web Pages, [redacted]

[redacted]