



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

Date: 06/30/05

Contact Person:

Number: **200538028**
Release Date: 9/23/05

Identification Number:

Contact Number:

UIL Numbers: 501.03-00

Employer Identification Number:

Legend
B =

Dear :

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 submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were established on October 31, 2003. Your purpose is to "assist over extended consumers in the repayment of unsecured debt, mainly credit card debt...Each individual having a unique financial situation and B having to follow structured guidelines from each creditor is not always possible to help everyone through our debt management plan." Your Articles of Incorporation provide that your purpose is to engage in the following activities:

To provide non-profit credit counseling services, including but not limited to, the following: financial and budgetary advice and judgment to individuals in order to create a budgetary plan, consolidation and restructuring of unsecured consumer debt, creation of a plan which provides for an individual to turn over an agreed amount of that individual's income to the non-profit corporation for the purpose of distributing it to that individual's creditors pursuant to the terms and conditions of the plan which the individual has approved and which may provide for smaller payments or a shorter term than the original agreement with the

creditor, providing educational services relating to the use of credit.

Your sources of financial support will consist of debt management plan (DMP) fees (see proposed budget for years one and two). You will receive money from the client (i.e. monthly and initial set-up fees) as well as money from the creditors (i.e. fair share contributions). Securing clients from Internet lead-generating companies will constitute your primary fundraising program. Your workers will be supplied with 300 new leads per month. You state that you use an outside lead company. You will also use your Internet site, as well as a national advertising campaign to generate leads. You state that "these advertising campaigns will allow B to be more publicly recognized and are expected to generate a large amount of potential business." You state that your largest expense is the expense related to generating leads. On page 19 of your Business Plan, you state that you will be optimizing your website to generate leads and familiarize your name for future branded campaigns."

When asked to provide copies of promotional literature (even in draft form) used to attract members of the general public to become clients, you state that such promotional literature has not yet been prepared. You also state that you cannot afford to design advertising materials, even in draft form.

Your proposed budget contains no line item for educational expenses. You state that the educational materials are provided in the "congratulations package." However, your "congratulations package" only includes information on acquainting the consumer with the DMP and how it works. It provides information on why the consumer needs to make the payment on time, what should be expected from creditors, as well as contact information if the consumer has questions. You state that you plan to have an educational department and that you plan to hold monthly evening classes for financial education and budget planning. When asked about your program, you did not provide literature announcing or describing the classes (even in draft form), a copy of the class syllabus or agenda, or any handouts, including audio and video (even in draft form). On page 15 of your Business Plan, you state that you "will continue to educate your clients while enrolled in a DMP. This education will be performed through interactive websites and quarterly mailings." You failed to provide any information regarding services or materials you plan to provide your clients while they are enrolled in your DMP.

The document you initially send consumers inquiring about your services states the following: "The CUSTOMER(S) is looking to consolidate his/her unsecured debt and make one reasonable and affordable periodic payment to his/her creditor(s). The CUSTOMER also requests B to establish a repayment Plan that will satisfy CUSTOMER(S) creditor(s). Based on the CUSTOMER(S) specific creditor(s) this Plan may or may not be affordable." The document that is sent out after the evaluation is complete and the consumer information is gathered states that "by contacting B, you

[the consumer] have joined the growing number of consumers who have discovered the benefits of debt management.”

Regarding your employees' education and experience, you state that you look for an employee's desire to help people and the willingness to learn. A counselor's bonus is based on length of employment, level of certification, customer retention, and attention to policy. As a result, your counselors are partially evaluated on the number of DMP sales that they make.

When asked whether you limit your services to a particular class of people, you state that your management plan is only limited by the creditors (banks) and the guidelines that the consumer has to fit into.

You submitted the scripted dialog between the credit counselor and the consumer. There are several types of presentations that your counselors may use. A representative sample is the following:

Let me take a minute here first, to explain what we are going to be doing for you. The first thing we will be doing is providing you with an evaluation to determine what the payments need to be and what the savings will be with the bills that you have. Then, if the program we are able to set up for you is something you want to move forward with, we'll get things started right away. With being on our program, the only thing you'll need to do is make your one monthly payment on time to us. What we will be doing is making the individual payments for you to each of your creditors on our program. With our company sending the payments for you, your creditors will lower the interest rates that they're charging to help you become debt free in a much faster time frame. We will provide you with educational tools to assist in better budgeting on your end. We will also help to reduce the payment that you're making monthly, if you need us to, allowing you to be able to follow through with the program. What this means to you, is you'll have a simple payment plan to make budgeting easier, you'll be out of debt much faster than on your own, you'll save an enormous amount of money, and you'll be in a better position for banks to lend to in the future. At this point, do you understand how we will be able to help you? Perfect.

You also state that you cannot help the consumer with those bills in which the companies that are providing the financing will not participate with any DMPs. Moreover, the parts of the dialog that deal with setting up and presenting the fax/email, setting the payment, client is current/behind with credit card debt, and the final congratulations script all focus on the DMP aspect of your operations.

According to page 11 of your Business Plan, you state that your “program follows a pre-established guideline set by the creditors and is targeted toward consumers who are overextended to minimize any adverse effects on the consumer’s credit rating.” In discussing your fee structure, you state that “this innovative fee structure will allow B to be the most cost effective full service debt management program.” On page 13 of your Business Plan, you state that your “main product is the administration of a debt management plan (DMP) for qualified consumers.”

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 its net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(b)(1)(i) of the Code provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its “articles”) as defined in subparagraph (2) of this paragraph:

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

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(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) defines 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.

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. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

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 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 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. 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 an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and 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, the totality of the organization’s activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was indicative of a business. Therefore, the court 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.

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 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 is an umbrella organization made up of numerous credit counseling service agencies. 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 did provide such services free of charge. As an adjunct to the counseling function, they offered a debt management plan. Approximately 12 percent of a professional counselor's time was applied to the debt management plan as opposed to education. The agencies charged a nominal fee of up to \$10 per month for the debt management plan. This fee was waived in instances when payment of the fee would work a financial hardship.

The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from service fees.

The court found the organizations exempt under section 501(c)(3) because providing information to the public regarding the sound use of consumer credit is charitable in that 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 charitable, 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) or to provide its services solely without charge. Nonetheless, these agencies did not charge a fee for the programs that constituted their principal activities. They charged nominal fees for services that were incidental. Moreover, even this nominal fee was waived when payment would work a financial hardship.

In Easter House v. U.S., 12 Ct. Cl. 476 (1987), aff'd 846 F. 2d 78 (Fed. Cir 1988), the court found that adoption services were the primary activity of the organization. In deciding that the organization conducted adoption services for a business purpose rather for a charitable purpose, the court considered the manner in which the organization operated. The record established a number of factors that characterize a commercial activity and which were evident in the operations of Easter House also. The court determined that the organization competed with other commercial organizations providing similar services; fees were the only source of revenue; it accumulated very

substantial profits, because it set its fees in order to generate a profit; the accumulated capital was substantially greater than the amounts spent on charitable and educational activity; and the organization did not solicit and did not plan to solicit contributions. The court also found a corporate-type structure in the classes of memberships (including a single life member having inherent power that the holder could transfer like stock), and dependence on paid employees.

In Share Network Foundation v. Commissioner, T.C. Memo 1999-216, the court held that the petitioner failed to qualify for exempt status under section 501(c)(3) of the Code because it did not describe its proposed activities in sufficient detail. The court found that “the record is devoid of sufficient documentation or other substantive information regarding petitioner’s organization, activities, or operations. It also stated that “what little information petitioner did provide, pursuant to respondent’s requests, was extremely vague and, in our view, simply an attempt by petitioner to avoid disclosing the requested information.”

Rev. Proc. 90-27, 1990-1 C.B. 514, provides that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

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.

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, holding the funds in a trust account and disbursing 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 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.

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.

Based on our analysis of your activities and in light of the applicable law, we have determined that you are not organized nor operated for a tax-exempt purpose under section 501(c)(3) of the Code. Your Articles of Incorporation state that your purpose is to provide non-profit credit counseling services, including but not limited to, consolidating and restructuring unsecured consumer debt, financial and budgetary advice, among other things. These services do not further a tax-exempt purpose under section 501(c)(3), and therefore, you do not meet the organizational test as described in the Code.

You have also failed to establish that you are or will be operated for either a charitable or educational purpose. In fact, the administrative record demonstrates that you will be operated for the substantial non-exempt purpose of conducting a commercial business. Your operation will also serve to further the private interests of the credit card companies, and other creditors.

That you will be operated as a commercial business is reflected in the fact that you use "leads" to generate a large amount of potential business. In fact, the largest expense you incur is your expense related to buying leads. Your presentations, correspondence, and business plan all focus on enrolling consumers on a DMP as your primary goal. Furthermore, your bonus structure is partially based on consumers who participate in a DMP. When asked whether you limit your services to a particular class of people, you state that your management plan is only limited by the creditors (banks) and the guidelines that the consumer has to fit into. You are unlike the organization described in Rev. Rul. 69-441, 1969-2 C.B. 115, which aided low-income individuals and families who have financial problems, thereby relieving the poor and distressed.

Moreover, the fact that your revenue will be derived exclusively from service fees from DMP participants and fair share from creditors shows that you will be operated as a commercial for-profit business. In fact, securing clients from Internet lead-generating companies will constitute your prime fundraising program. There is no evidence that you receive contributions or gifts from disinterested members of the general public. Thus, you are unlike the organizations described in Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S. Tax Cas. 9660 (D.D.C. 1978) which 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 fees.

Because the sale of DMPs will apparently be your sole activity, you must show that the sale of DMP services is incidental and integral to a substantial and substantive educational program. Section 1.501(c)(3)-1(d)(3). Financial counseling can be considered educational. See Rev. Rul. 69-441 and CCS of Alabama, *supra*. However, a single substantial non-exempt purpose is sufficient to preclude exemption, regardless of the number of exempt purposes. See Better Business Bureau of Washington, *supra*. A purpose of providing education will not overcome an additional, substantial commercial purpose. American Institute for Economic Research, *supra*.

You have failed to describe your operations in sufficient detail to show that you are furthering an exclusively educational purpose. See Share Network Foundation and Rev. Proc. 90-27, *supra*. You did not provide any evidence that your DMP will be an incidental adjunct to a substantial and substantive program of public education and individual counseling. You have provided no materials that indicate you will have a substantive on-going educational program directed to the individuals and families you serve in your DMP. Furthermore, you have provided no evidence that you will conduct "credit counseling" seminars and/or conduct workshops directed to the general community. You failed to submit literature announcing or describing classes (even in draft form), a copy of a class syllabus or agenda, as well as any handouts, including audio or video (even in draft form). You also failed to provide advertising materials when asked by the Service. Your primary goal and a majority of your time appear to be devoted to selling and maintaining DMPs, thereby furthering a substantial non-exempt purpose. Your business plan states that your "main product is the administration of a debt management plan (DMP) for qualified consumers."

In addition to operating for substantial non-exempt commercial purposes, you provide substantial private benefit to credit card companies and other creditors by operating as their collection agency. The "fair share" paid by the credit card companies would undoubtedly result in significant savings over the possible costs of not recovering any of the unpaid debt owed them. You even acknowledge that you are bound by "creditor guidelines" as to whether you can provide services to a consumer. Thus, the creditors completely control your operations, and clearly realize substantial financial benefits through their business relationship with you.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code because you have failed both the organizational and operational tests, and therefore, 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).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If it is convenient, you may fax your reply using the fax number shown in the heading of this letter. If you fax your reply, please contact the person identified in the heading of this letter by telephone to confirm that your fax was received.

Internal Revenue Service
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure:
Notice 437