TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200536022**
Release Date: 9/9/05
UIL: 501.00-00

Date: 05/26/05

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:
B=
C=
D=
E=

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 incorporated in the state of on . In your Form 1023 Application, you have represented that you were "incorporated as a nonprofit corporation to assist low-income families and individuals with financial problems and to help reduce the incidence of personal bankruptcy." With regard to the people you intend to provide services to, you stated the following in response to our letter dated September 2, 2004: "We intend to limit our services to individuals encountering financial difficulties. We stand ready to serve all clients who seek service regardless of an individual's ability to pay, the creditors owed or the dollar amount owed." The

information provided indicates that the primary activity in furtherance of your purposes will be the sale of debt management plans (DMPs) to the general public.

Your Board of Directors consists of B, C and D. Information provided by you indicates that none of the Board members reside in the state where you are incorporated and conduct your business. The information also reveals that none of your Board members have extensive experience or education in credit counseling. Their experiences are in business development, high school guidance counseling, and fundraising. Moreover, there is no evidence that your counselors have been certified to perform credit counseling services.

In order to participate in your DMP program, clients will be charged an enrollment fee not exceeding $75 or the maximum allowed under state law. The maintenance fee for the DMP will not exceed the "lessor of $50 for each monthly payment made on an account or the maximum fee allowed by state law." You have stated that these fees will be paid on a "voluntary" basis. You will also receive revenue from creditors who choose to participate in your "fair share" program. Your DMP program will be your sole source of revenue. You currently have no fundraising program in operation.

Your only source for training materials for your counselors will be provided by E. E's website offers an on-line credit counseling course with examination and certification for counselors. You also submitted a sample copy of "educational materials" that you will provide your counselors. These materials consisted of an un-indexed, unbound compilation of approximately 75-80 pages covering a range of financial planning topics. You did not explain where, when or how this material would be used in any "counseling" sessions. You also did not indicate who authored the materials. In addition, you provided no information regarding any seminars or workshops you will offer the general public nor any materials you would use to conduct such seminars or workshops.

You have indicated that you will advertise and market your services through speaking out at community events and networking with mortgage bankers, banks, clergy and other social service organizations. Your financial statements anticipate no expenditures for advertising. You also anticipate no expenditures, including grants and contributions toward educational and charitable programs.

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

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 assigns the burden of proof to an applicant organization to show that it serves 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 under privileged 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, were 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 dept management plan. Approximately 12 percent of a professional counselor's time was applied to the dept management plan as opposed to education. The agencies charged a nominal fee of up to $10 per month for the dept 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 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.

Our analysis of the information you submitted shows that while you are organized for charitable purposes you do not satisfy the operational requirements to be recognized as exempt under section 501(c)(3). You have 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 financial interests of the credit card companies, and other creditors.

That you will be operated as a commercial business is reflected in the fact that your revenue will be derived exclusively from substantial fees received from clients enrolled in DMPs and fair share payments received from creditors. Moreover, like some other for-profit financial service businesses, you will make the availability of your services known through interacting and networking with for-profit mortgage banks, bankers, and other means. You have indicated that you do not anticipate having a fundraising program in operation.

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 CCCS of Alabama, supra. However, a single substantial non-exempt purpose is sufficient to preclude exemption, regardless of the number of exempt purposes. Better Business Bureau of Washington, supra. A purpose of providing education will not overcome an additional, substantial commercial purpose. American Institute for Economic Research.

You have failed to provide any evidence that your DMP will be an incidental adjunct to a substantial and substantive program of public education and individual counseling.

In fact 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. The only "educational" materials provided by you consisted of a copy of 75-80 pages of un-indexed, unbound "canned" materials that appeared to come from an Internet website. There is no indication of who authored the materials. You did not explain when, where or how these materials would be used to "educate" individuals or families enrolled in your DMP.

You also have provided no evidence that you will conduct "credit counseling" seminars and/or conduct workshops directed to the general community. Moreover, you have not provided substantial evidence that you will restrict your debt management services to low-income customers. If you do have "low-income limits" for participation in your debt management program, you have provided no evidence of the specific guidelines that participants will be required to meet. You have provided no advertising materials stating that your services will be restricted to low-income individuals and/or families. In fact, information provided by you indicates that your services will be available to the general public without regard to individual or family income. That you may allow so-called "low-income" individuals and/or families to make "voluntary payments" or not pay at all, does not change our view that these payments will in fact be a fee charged for services rendered by you. The Service position is that a transfer to charity will be treated as a charitable contribution only if the transfer is made without adequate consideration. Since a DMP is something of value, a contribution in connection with one will be treated as a fee rather than a contribution.

In addition to operating for a substantial non-exempt commercial purpose, you would be providing substantial private financial benefit to the credit card companies and other creditors by operating as their collection agency. The "fair share" paid by the credit card companies would clearly result in significant savings over the possible costs of not recovering any of the unpaid debt owed them. These companies would clearly realize substantial financial benefits through their business relationship with you.

We note that none of the members of your Board of Directors has any prior education or experience in matters directly related to credit counseling. Moreover, you have provided no credible evidence that your "counselors" have been trained and certified by E, or passed any other examination administered through a "credible" credit counseling education organization. We also seriously question the effectiveness of your Board members in properly and effectively directing your business operation, when none of these individuals reside in the state where you operate.

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 judgment 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
TE/GE (SE:T:EO:RA:T:1)

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