



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200611035**

Release Date: 3/17/06

SE:T:EO:RA:T

UIL: 501.00-00

Date: December 20, 2005

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

1120

Tax Years:

All

Dear _____ :

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(3).

We made this determination for the following reason(s):

You are not organized exclusively for exempt purposes because your articles of incorporation do not limit your purposes to those within section 501(c)(3) of the Code.

You have failed to establish that you are operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. You did not describe your proposed activities in sufficient detail to show that you will engage primarily in activities which accomplish an exempt purpose described in section 501(c)(3). You have failed to establish that your activities will serve a public rather than a private interest. Finally, you have failed to establish that your net earnings will not inure to the benefit of private shareholders or individuals .

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date that we mailed this letter to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: May 31, 2005

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

LEGEND

UIL: 501(c)(3).03-00

X or You =

Dear :

The industry providing consumer credit counseling and credit repair has changed over the past 30 years. In 2002, the IRS began a wide-ranging study of organizations offering credit counseling, debt-management and credit repair services.

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.

Facts

You were organized as a nonprofit public benefit corporation under the laws of your state to "assist consumers who suffer from adverse credit in the improvement of their credit rating and in securing extensions of credit." (Articles of Incorporation) In your application you further explain: "The correction of individual consumers' credit history is achieved through a detailed analysis of the various items included in a credit report and specific challenges of inappropriate items based on applicable state and federal laws." In correspondence of November 17, 2004, you maintain that "We do not do 'Credit Repair.' We verify and dispute items that are inaccurately reported. The average item that can be removed takes 3-6 months to do so." Your website states:

Although you do not describe your service as credit repair, the Credit Repair Organizations Act, *supra*, defines credit repair organizations as:

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...

This describes your services accurately.

According to your procedures, your clients contact you. You do not conduct any telemarketing or solicitation. "On average [your employees] spend 10-20 minuets (sic) speaking with a client before they sign up. Once they sing (sic) up our customer service representative calls them to welcome them to our service, gives them a password so they can access their information on the website and letting them know what to expect." You only provide one type of service. Your "employees do not give any alternatives or advice." (Correspondence of November 17, 2004.)

All of your revenue is derived from fees charged to consumers. A schedule of fees that you submitted with your correspondence of November 17, 2004 shows that you charge \$ to a couple who earns between \$ and \$ per year. To a couple that earns more than \$ you charge \$. The schedule of fees states that you do not charge anything to people earning less than \$ per year. However, you have not provided evidence of how many, if any, clients you have served for free. Clients pay in advance of the service. "The client pays us directly right up front. We do not do the work and receive payment after the broker closes the loan..." (Correspondence dated December 13, 2004.) There is a mention of sliding scale of fees on your website, but no specifics, and you confirmed that you do not supply your customers with any material explaining your fees. (Correspondence of November 17, 2004.) You do not solicit or receive donations, nor do you intend to initiate fundraising in the future. You anticipate revenues of \$ or more per year.

Your two incorporators now serve as your president and vice-president, and are your highest paid employees, each earning \$ per year. Two other board members have outside businesses that depend upon clients obtaining credit, and thus could benefit from your operations. One works at a mortgage company, processing mortgage loans applications, and the other is a car salesman.

Clients are referred to you by mortgage brokers, your only source of clients. You communicate with the mortgage brokers in person and through your website. "We do presentations at mortgage broker group meetings, offices, and events that brokers hang out at." A "broker" page on your website indicates the pitch that you make. It promotes your service to

brokers as a “secret weapon...to dominate the sub-prime market.” It tells mortgage brokers that they can “dominate the subprime market.” It alleges that, “There is no reason that a loan officer or mortgage broker should not take advantage of our service to acquire two or more loans per month than they have in their current pipeline.” The site further promises a future enhancement to allow brokers and loan officers to “track the progress of their clients who are using X to resolve credit issues.” (Webpages, attached to your correspondence of November 17, 2004.)

LAW

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and certain other enumerated 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(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
- (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(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 requires 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 underprivileged as well as the advancement of education.

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 one 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 also services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed, for the sake of argument, that the organization had an educational purpose. However, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and therefore the organization was not entitled to exemption.

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 commercial. The court found that the corporation failed to demonstrate that its services were not in competition with commercial businesses. In addition, the court found that the organization’s 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 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 Living Faith, Inc. v. Commissioner, 950 F. 2d 365 (7th Cir. 1991) aff’g 70 T.C. 352 (1978), the court held that a vegetarian restaurant and health foods store that adhered to the

principles of the Seventh Day Adventist Church was not operated exclusively for exempt religious purposes, but rather for a substantial commercial purpose. The court examined the method of operations to infer the purposes. Although the organization catered to the dietary restrictions of the Church, its primary activities were managing a restaurant and health food store, operated in competition with commercial entities, charging competitive prices set by formulas common in the retail food business, and using commercial promotional methods.

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C., 2003), the court concluded that the Foundation was operated for a substantial non-exempt purpose. It based this conclusion on the manner in which the organization managed a 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 method of inferring 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.

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 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).

15 U.S.C. section 1679a(3). 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).

RATIONALE

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 and that it is not operated for a substantial non-exempt purpose, and does not serve private purposes. You have failed to establish that you are both organized and operated exclusively for exempt purposes. You do not serve a charitable class, or educate the public or counsel individuals. Rather, you have the substantial non-exempt purpose of operating a

commercial credit repair business. In addition, your operations provide significant private benefit to individuals and exhibit a significant risk of inurement.

The conflicting provisions in your Articles of Incorporation indicate that you are not organized exclusively for exempt purposes. Article IV states that you are “organized and operated exclusively for charitable purposes within the meaning of Internal Revenue Code § 501(c)(3).” However, Article II states that “The specific purpose of the corporation is to assist consumers who suffer from adverse credit in the improvement of their credit rating and in securing extensions of credit.” Helping consumers to improve credit ratings and obtain loans are not exempt purposes. Therefore, your articles violate Section 1.501(c)(3)-1(b)(1)(i) of the regulations in two ways. They do not limit your purposes to exempt ones, and they expressly empower you to engage in activities that are not in furtherance of exempt purposes. The general statement of charitable purposes is insufficient to overcome the express statement of non-exempt purposes.

An organization will only be regarded as operated exclusively for exempt purposes if it engages primarily in activities that accomplish one or more of the purposes specified in section 501(c)(3) of the Code. A number of courts have examined nonprofit organizations conducting businesses to determine whether the business was conducted for an exempt purpose or for a commercial, and thus non-exempt, purpose. See B.S.W. Group, Easter House, Living Faith, and Airlie Foundation, *supra*. Competition with for-profit organizations conducting the same business is an important characteristic that the courts used to identify commercial purpose. It is clear that you consider credit repair services as your competitors, because you explain on your website why your methods are superior to other credit repair services. Another factor relied upon by courts is use of commercial promotion by the organization claiming exempt status. Your website consists of short explanations of your activities and the exhortation to “sign me UP!” It serves no purpose apart from commercial promotion. However, the promotion may be an indirect one, aimed at mortgage brokers. According to your explanation, all of your clients are referred to you by mortgage brokers. These are professionals in a commercial enterprise who will indirectly benefit from your efforts for their clients. This is another commercial method of promoting your business. Furthermore, your application states that “field representatives are used for first contacts statewide.” There is no further explanation, but we presume that this refers to mortgage brokers with whom you have ongoing relationships.

Your services are advertised on the Internet, and available to all. You do not restrict them to a charitable class. Your employees do not provide education in the form of explanations of alternatives, counseling or advice. You do not conduct public education through seminars. The schedule of fees that you provided was on a blank page. Neither that schedule, nor anything else in the file supports your assertion that these are the fees that you charge. You have provided no evidence that you have performed services without fees for individuals and families who earn less than \$ per year.

Like a for-profit business, all of your revenue comes from very substantial fees. They are set high enough to cover all of your costs. You do not currently receive donations or grants, and you do not have a fundraising program to solicit them in the future. The court in B.S.W. Group found similar factors pivotal in that case.

Your application for exempt status actually serves a commercial purpose. The Credit Repair Organizations Act, *supra*, forbids for-profit corporations from collecting fees before performing credit repair services. Your activities fit the definition of credit repair. You charge fees in advance, which would be illegal if you were a for-profit enterprise. As an exempt organization, you can continue to collect large fees in advance of service.

In order to be recognized as exempt from federal income tax, an organization must meet standards in addition to operating for exempt purposes. The organization may not allow any of its assets to inure to private persons. Your corporate structure creates a risk of inurement. Of your five-member board, two members are highly compensated employees and two are professionals in a position to benefit from your activities. The remaining person appears to be independent, but does not have any professional experience with credit. You do not owe any accounting to an outside body such as a grantor. Thus, there is no check upon the compensation that the officer-employees pay themselves, or upon any other use they might make of your resources. Additional inurement may be provided to the two directors who may benefit from your activities in their outside employment.

Your activities provide significant private benefit to the unrelated mortgage brokers who refer clients to you. The page on your website addressed to mortgage brokers discusses how they will benefit from referring clients to you. It even includes calculations of the number of additional loans, and therefore commissions, that a broker might obtain. It also mentions a planned feature of your operations intended to assist the mortgage brokers in keeping track of their clients who are using your services.

You are not organized for exempt purposes, you operate for non-exempt commercial purposes, and your operations pose a high risk of inurement and private benefit. 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, and do not intend to protest our denial of exempt status, 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 you also disagree with our proposed deletions, you should send your comments on the deletions with your protest statement, and not to the address shown in Notice 437.

Internal Revenue Service
TE/GE (SE:T:EO:RA:T)

1111 Constitution Ave, N.W., PE-
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