



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Date: August 10, 2005

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

SIN: 501.00-00

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 _____. Your Articles of Incorporation show that you are incorporated as a for-profit corporation with the authority to issue 50 shares of stock, having an individual par value of \$10.00. You have provided no evidence that you have amended your Articles or reincorporated as a non-profit under section 501(c)(3) of the Code. The _____ Department of State website indicates that you are currently operated as a for-profit company. Although you represented in your Form 1023 Application that you are a successor to a for-profit company, you have continued to operate without changing your corporate structure. Your for-profit business focused exclusively on debt reduction programs with the sale of debt management plans (DMPs) as its primary activity. You state that as a non-profit, you will also offer credit counseling and education.

The information you provided indicates that your primary activity will continue to be the sale of DMPs. You have represented that clients enrolling in your DMP will be charged a \$50.00 program fee upon qualification and enrollment. Moreover, clients will pay \$35.00 or 7.5% of the monthly payment. You also plan to receive revenue from creditors who choose to participate in your "fair share" program. Your DMP program will be your sole source of revenue. You have stated that, "no fundraising activities have been or will be planned."

You have submitted a training manual for your counselors' that consists solely of a five-page document. The 5 pages cover the following topics relating to credit counseling and debt

management: “Benefits of the client,” “How to know if the DMP is needed,” “What debts can be consolidated,” and “Unsecured Debt.” The substance of each topic is clearly directed to convincing clients of the benefits of enrolling in a DMP. Your sample phone script is also tailored to persuade clients’ of the benefits of enrolling in a DMP. You did not indicate who authored the “training” manual, or how these materials would be used in any “counseling” sessions. 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 claim that your services will be directed to low-income individuals and families. You have provided no evidence that your services are restricted to these individuals or families. For example, you have not provided any demographic or other studies showing that your clientele are exclusively low-income individuals or families. Materials and information you provided indicate that your services are available to anyone who is able to pay your fees.

You have indicated that you will advertise and market your services through local newspapers, radio ads, and word of mouth. Your proposed budgets anticipate no expenditures, including grants and contributions, toward educational and charitable programs.

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(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(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 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 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.

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 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 before a ruling or determination letter will be issued.

An organization must establish through the administrative record that it operates as a section 501(c)(3) organization. Denial of exemption may be based solely upon failure to provide information describing in adequate detail how the operational test will be met. American Science Foundation v. Commissioner, T.C. Memo. 1986-556; La Verdad v. Commissioner, 82 T.C. 215, 219 (1984); Pius XII Academy v. Commissioner, T.C. Memo. 1982-97. Exempt status can be recognized in advance of operations if proposed operations can be described in enough detail to permit a conclusion that the organization will clearly meet the requirements of section 501(c)(3). American Science Foundation v. Commissioner, T.C. Memo. 1986-556. The organization has the burden of providing sufficient documentation or other substantive information regarding its activities and operations, which would establish entitlement to tax-exempt status. Information that is vague or nonspecific is not sufficient to meet the requirements under section 501(c)(3). Tully v. Commissioner, T.C. Memo, 1999-216.

Based on the information you submitted, we cannot conclude that you are organized exclusively for charitable and educational purposes. You have the authority and have apparently issued 50 shares of stock, having an individual par value of \$10.00 giving your shareholders an ownership interest in your assets. Your Articles of Incorporation were filed under the Business Corporation Laws indicating your intent to operate as a for-profit business corporation.

Moreover, 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 operate for the substantial non-exempt purpose of operating a business.

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. Moreover, you will continue to make the availability of your services known through advertising in local newspapers, radio ads, and other means. These are the methods commonly used by for-profit businesses. You have indicated that you do not anticipate having a fundraising program in operation. Your proposed budgets show no expenditures, including grants and contributions made to any educational or charitable programs.

Because the sale of DMPs will 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 substantive on-going educational programs directed to the individuals and families you serve in your DMP. The only “educational” materials you provided consisted of a copy of 5 pages of “training” materials that will be used to train your counselors. The substance of the topics covered in these five pages is clearly and exclusively focused on how to persuade clients to enroll in a DMP. Your sample “phone script” is also tailored to convince clients of the appeal and benefits of enrolling in a DMP. 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, the information you provided indicates that your services will be available to the general public without regard to individual or family income.

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 results in significant savings over the possible costs of not recovering any of the unpaid debt owed to them. These companies realize substantial financial benefits from their business relationship with you.

The DMP services that you offer are identical to those provided by your “for-profit” business as you continue to operate through the same corporate structure. Under the circumstances, we further conclude that your operations result in inurement to your shareholders, directors and officers.

Rev. Proc. 90-27 requires an applicant to submit sufficient information during the application process for the Service to conclude that the organization is in compliance with the organizational and operational requirements of section 501(c)(3) before a ruling is issued. You have not sufficiently and fully described your activities as they relate to the number of people you expect to enroll in your DMP and other financial services programs, where, when or how you would “educate” these individuals and families, or provided evidence that you will have a substantive and substantial education program tailored to the specific needs of these individuals and families. Additionally, you have not established that you have or will meet with clients on a regular, systematic basis to provide substantive counseling in credit and financial matters. The vague and nonspecific information and documentation you provided does not meet the burden of showing that your activities and operations are such that you are entitled to recognition of exemption under section 501(c)(3). See Tully, supra.

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