TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200510031**
Release Date: 3/11/2005

Date: 11/15/04

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Legend:

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X or You =
B =
C =

Dear :

The industry providing consumer credit counseling services has changed over the past 30 years. In 2002, the IRS began a wide-ranging study of developments and of organizations offering credit counseling and debt-management service. On July 30, 2004, the IRS Office of Chief Counsel released a Chief Counsel Advice (CCA 200431023, 2004 IRS CCA LEXIS 22). It presents a comprehensive legal analysis of whether and when credit counseling organizations can qualify as charitable or educational organizations described in section 501(c)(3) of the Internal Revenue Code. We have enclosed a copy of the Chief Counsel Advice for your information.

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.

The Internal Revenue Code provides for the exemption from federal income tax of entities organized and operated for charitable, educational, scientific, religious, and certain other purposes. Relieving the poor and distressed is considered a charitable purpose. Instruction and training for the purpose of improving or developing an individual's capabilities, or educating the public on subjects useful to the individual and beneficial to the community are also considered charitable or educational activities. Thus, an organization that limits credit counseling and debt-management services to low-income customers or, as its primary activity, provides education to the public on how to manage personal finances may qualify for exemption

under section 501(c)(3). However, your articles of incorporation state your purpose as providing "assistance to those who are in need of the implementation of sound financial practices for the reduction and/or elimination of overburdening debt." The sound financial practices that you refer to appears to be the sale of dept management plans.

Your corporate structure includes shareholder-members, indicating that you are or intend to distribute earnings to your insiders, and are organized and operated for the benefit of private interests such as your founders and members. The minutes of your organizational meeting, on November 3, 2003, record a resolution issuing "TEN (10) shares of fully paid and nonassessable Membership Certificates of the Corporation" to each of two directors, B and C. The original articles of incorporation granted to members and the by-laws grant to shareholders the authority to elect directors. The by-laws make elaborate provision for shareholder's rights, stock transfer books, voting procedures, proxies, and voting trusts. Such a structure and allocation of authority is common in for-profit corporations, but violates the most fundamental rule for exempt organizations, that the assets of the organization not inure to a private shareholder or individual.

To qualify under section 501(c)(3), an organization cannot have a non-exempt purpose that is more than insubstantial. Selling and administering debt management plans (DMPs), as the attached IRS Chief Counsel Advice points out, is not inherently a charitable or educational activity, and is often conducted as a commercial activity. A payment plan will not be considered substantial if it is an integral part of an ongoing educational program of one-on-one credit counseling, or an incidental adjunct to a credit counseling organization's primary activities of public education and individual counseling. However, if it is a substantial purpose of an organization, and not integral or incidental to an exempt purpose, it will be a bar to exemption under section 501(c)(3) of the Code. The Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), 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.

Section 501(c)(3) organizations must also meet other standards. Most importantly, the organization must not distribute net earnings to insiders (the prohibition against inurement) and it must operate for the benefit of public rather than private interests (the prohibition against private benefit). An organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, for-profit affiliates, or persons controlled directly or indirectly by such private interests. A finding that a credit counseling agency provides integrated services to a related or unrelated for-profit corporation (resulting in inurement or private benefit to the for-profit entity) will prevent recognition of exempt status.

Your operations fail both the organizational and the operational tests for exempt status. First, you do not operate for an exempt purpose. Your articles of incorporation do not state an exempt purpose, nor do you limit your services to the poor and distressed or to another charitable class. In the description of your activities in your Application for Exempt Status (Application) you mention education only briefly. There is little evidence in your file or on your websites of educational activity. You do not conduct any public education. There is no

indication that your employees instruct individuals. You have posted some materials on your website, but you use them as additional promotion of your DMP, by exhorting the reader to "APPLY ONLINE NOW" at the end of each very brief discussion.

Second, the manner in which you conduct your activities shows that you operate for the non-exempt purpose of running a commercial business. Your website and customer agreements show that providing debt-management services is your only activity. You sell debt management plans in a normal, commercial manner. You advertise on the Internet and purchase leads to expand your customer base. The start-up fee charged to your customers is equal to the first monthly payment, and a monthly administrative fee is equal to one percent of the annual payment up to a maximum of $100. Your revenues are entirely derived from "fair share" rebates from creditors and from fees from your customers. You have no fundraising program.

The composition and power of your board present a serious risk of inurement. Your three-person board is composed entirely of close family relations: a father and a son who is also a brother-in-law to the third person. Two of the directors are the members holding certificates, mentioned above. The same two directors are full-time paid employees and thus have an additional financial stake in your affairs. The by-laws give the directors the authority to set compensation for the directors, subject only to the power of the shareholders to alter it. In this case, the founders, the shareholders, the directors and the officers are all the same people. There is not even one outside, disinterested board member to speak for the community. We must conclude that you violate the second fundamental rule for exempt organizations, and operate for private, not public benefit.

You have not established that you are organized and operated exclusively for exempt purposes and that you are operated for public 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.
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
Chief Counsel Memorandum
Web page