



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

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Date: October 19, 2004

Contact Person:

Identification Number:

Contact Number:

UIL Numbers: 501.03-00

Employer Identification Number:

Legend:

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Dear _____ :

The market for consumer credit counseling services has undergone changes in the past 30 years. In 2002, the IRS began a comprehensive study of organizations offering credit counseling and debt-management services. On July 30, 2004, the IRS Office of Chief Counsel released IRS Chief Counsel Advice Memorandum (CCA) 200431023, 2004 CCA LEXIS 22, presenting a comprehensive legal analysis as to whether 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 CCA 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.

Your primary activity is the sale and maintenance of debt management plans (DMPs) for a fee. You maintain that thirty percent of your time is devoted to negotiating with creditors to lower the monthly bills for consumers. Another thirty percent of your

time is devoted to ensuring that monthly payments are made on the consumer's debts, which is accomplished by an electronic funds transfer system. Twenty percent of your time is devoted to providing in-house workshops on debt management and credit issues. You are located at A. According to your Statement of Revenue and Expenses, there is no line-item expense for educational workshops and programs. You maintain that the remainder of your time is devoted to working with community agencies that provide financial programs, working with tax professionals to provide tax advice, and consulting with consumers on the phone on ways to get out of debt.

You state that you do not limit your services to any particular class and no particular criterion must be met to participate in any of your programs. There is a one-time fee of \$75.00 for enrolling in the DMP, as well as a \$20.00 monthly support fee. You also state that your sources of support include membership fees at \$30.00 per client per month, and fees paid to you by vendors estimated at six percent of the debt paid on behalf of your members (i.e. fair share). You expect to receive most of your support from creditors, and you do not have a planned fundraising program. In your outreach script, you promote your DMP activities by discussing affordable repayment plans, with reduced interest rates that provide savings for consumers. You refer to "credit counseling" in your training manual as a service for budgeting and bill paying (i.e. complex DMPs). Your promotional material outlines the DMP services you provide. You also use a training manual on understanding and managing "leads." According to the manual, your software (B) is easy to use to maintain and gather information about leads.

Your customer service/counseling service representatives are responsible for reviewing new client files, explaining the DMP, ensuring that all client accounts can benefit from the program, enforcing participation in financial education, and receiving and resolving inquiries. All of these tasks are performed by an employee who has a high school diploma, two years of customer service experience, and computer literacy. You provided a sample client debt payment schedule in which you account for monthly expenses for food, personal, transportation, utilities, and housing. In this case, after restructuring the consumers' payments, they pay more each month than they were paying before you restructured their bills.

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(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 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, which held the funds in a trust account and disbursed 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 voluntary 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.

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S. Tax Cas. 9660 (D.D.C. 1978), the court held 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, which had been recognized as exempt under section 501(c)(3) in a group ruling, is an umbrella organization made up of numerous credit counseling service agencies. In this case, 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. The professional counselors used only 12 percent of their time for debt management programs. They did not limit these services to low-income individuals and families, but they provided their services free of charge. 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). Nonetheless, these agencies did not charge a fee for the programs that constituted their principal activities. A nominal fee was charged for the debt management services but was waived when payment 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 fees. Thus, the court concluded that “each of the plaintiff consumer credit counseling agencies was an organization described in section 501(c)(3) as a charitable and educational organization.” See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S. Tax Cas. 9468 (D.D.C. 1979), in which the facts were virtually identical and the law was identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

Based on our analysis of your activities and in light of the applicable law, we have determined that you operate primarily for non-exempt commercial purposes. Your primary activity is devoted to selling and maintaining DMPs to the general public for a fee. You state that 60 percent of your time is devoted to negotiating with creditors to lower monthly bills and using an electronic funds transfer system to ensure that payments are automatically made on the consumers’ debts. You use “leads” to generate and maintain a constant flow of potential clients. Your promotional material, training manuals, and outreach script promote the use of DMPs through promises to lower interest rates and providing timely automated bill-paying services. You do not limit your services to any particular class and no particular criterion must be met to participate in any of your programs. 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.

Although you maintain you will provide workshops on debt management and credit issues, you have failed to provide sufficient documentation supporting that assertion. In fact, you have failed to budget funds for educational material, workshops, or programs. Even if you did provide educational services, a majority of your time is devoted to selling and maintaining DMPs, thereby furthering a substantial non-exempt purpose.

Your financial structure does not resemble that of a typical charity because it is based entirely upon revenue earned by selling services to the public. You state in your application that your sources of support include service fees for participating in the DMP as well as fair share from creditors. You expect to receive most of your contributions from creditors. You have provided conflicting information as to the per month fee charged to each client, and you do not have a planned 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) in which they 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.

In addition to operating for substantial non-exempt purposes, you provide substantial private benefit to credit card companies. You are operating as a collection

agency for these companies. 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. These companies 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 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
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

Attachment:
IRS Chief Counsel Advice Memorandum
Notice 437