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Internal Revenue Service  
**Memorandum**

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subject: Credit Counseling Organizations

This Chief Counsel Advice responds to your request for further assistance in determining when a credit counseling organization qualifies for exemption under § 501(c)(3). This advice may not be used or cited as precedent.

This advice supplements Chief Counsel Advice 200431023 (July 13, 2004) (2004 CCA). Unlike the 2004 CCA, this advice does not address inurement and private benefit. In deciding how to develop your cases, you will want to consider questions of inurement and private benefit in addition to the questions of exempt purpose addressed in this memo.

This advice provides you with a legal framework to determine whether a credit counseling organization primarily furthers educational purposes. The critical inquiry is whether a credit counseling organization conducts its counseling program to improve an individual debtor's understanding of his financial problems and improve his ability to address those problems. We present two hypothetical fact patterns, one in which the organization's counseling furthers educational purposes, and one in which it does not.

## ISSUE

Whether a credit counseling organization that offers counseling and debt management plans to the general public operates in furtherance of educational purposes consistent with § 501(c)(3).

## CONCLUSIONS

Based on the statute, case law and published guidance, whether a credit counseling organization primarily furthers educational purposes within the meaning of § 501(c)(3) can be determined by assessing the methodology by which the organization conducts its counseling activities. The process the organization uses to interview clients and develop recommendations, train its counselors and market its services can distinguish between an organization whose object is to improve a person's knowledge and skills to manage his personal debt, and an organization that is offering counseling primarily as a mechanism to enroll individuals in a specific option (e.g., debt management plans) without considering the individuals' best interest.

In general, if you find that an organization's method of counseling is educational, you should conclude that the organization is exempt under § 501(c)(3), absent a showing of inurement or substantial private benefit. On the other hand, if you find that an organization's method of counseling does not further education, you should conclude that the organization is not exempt under § 501(c)(3).

## BACKGROUND

### A. 2004 CCA

The 2004 CCA provided a legal overview and general direction on how to develop credit counseling cases. It also included a legal analysis of whether a credit counseling organization is operating for the private benefit of a third party, and whether its activities resulted in inurement.

### B. Examination Findings

In your industry-wide credit counseling examination program, we understand that you now have identified cases that do not present the issue of inurement of earnings to founders or other insiders or private benefit to back-office service providers. Nevertheless, the facts, as developed, raise questions as to whether the organizations are, in fact, furthering exempt purposes.

Like the credit counseling organizations addressed in the 2004 CCA, the organizations that are prompting the current request for advice provide debt management plans as a substantial part of their activities. These organizations assert that they provide

substantial counseling and education to debtors. They make their services available to all members of the public, regardless of the size of their income or assets.

To determine whether these organizations qualify for exemption, you first should analyze whether the method by which they conduct their counseling programs is educational. We have developed two contrasting fact patterns to demonstrate how to conduct this analysis. The fact patterns are drawn in large measure from practices that you have observed in the course of examinations and determinations.

## FACTS

ABC Credit Counseling Organization (ABC) and DEF Credit Counseling Organization (DEF) have certain facts in common. Both organizations provide counseling and debt management services to the general public as a substantial part of their activities. Neither organization limits its services to low-income individuals. They provide counseling in person, by telephone, through the Internet, at classes and seminars and through films and publications. They receive their funding from contributions and grants (including payments from creditors), fair share payments and reasonable fees for services. Finally, they each are governed by a community-based board that is independent of creditors.

There also are a number of facts that distinguish ABC from DEF. These factual differences concern the method or process the organizations use to interview clients and develop recommendations, train their counselors and market their services.

### A. ABC Credit Counseling Organization

#### Counseling Sessions.

(1) ABC's counselors ask clients to provide detailed information about the type, amount and source of all significant items of income, assets, liabilities (including secured and unsecured debt), and expenses. This information will include the name of all creditors, outstanding balances and the amount of minimum monthly payments;

(2) ABC's counselors interview clients about their budget and finances, discussing topics including their employment, education, buying habits, significant expenditures, and any significant past or anticipated changes in their earnings, assets, expenses and liabilities, including the reason or cause for those changes;

(3) Based on this information, ABC's counselors develop and present to clients a number of options and strategies for addressing their debt problems, including creating and maintaining a budget, establishing debt management payment plans with creditors, negotiating directly with creditors on payment or interest rate relief, and filing for bankruptcy. The counselors also will discuss the advantages and disadvantages of

each of these options with clients and will make recommendations for which options are best suited to meet the clients' individual needs, goals and circumstances;

(4) The counselors also provide to each person who contacts the organization written materials on budgeting and managing personal finances and discuss these materials with them;

(5) ABC's counselors also provide referrals to other organizations for appropriate support services, such as employment, training, and psychological counseling; and

(6) ABC provides follow-up counseling to its clients as appropriate beyond the intake interview.

#### Counselor Education and Training.

(1) Counselors receive comprehensive training in counseling skills, personal finance, budgeting, and credit and debt management in live or interactive training sessions and through detailed written manuals;

(2) Counselors also receive training on how to develop options and recommendations that address the particular circumstances of each client;

(3) Counselors are trained to identify underlying personal problems (such as illness or loss of employment) that might contribute to financial problems and on making appropriate referrals; and

(4) Counselors are evaluated on how thoroughly and effectively they develop and present options to match the particular circumstances of each client. They are not evaluated or compensated based on whether their clients enroll for additional services provided by ABC (such as debt management plans).

#### Outreach and Advertising.

(1) ABC receives referrals from employers, union leaders, clergymen, community organizations or creditors; and

(2) ABC uses the Internet, mass media and direct mail to advertise its counseling and debt management services. The advertisements primarily focus on counseling services (based on visual prominence and relative amount of time and space devoted). Debt management plans are mentioned as only one possible option for addressing debt problems.

#### B. DEF Credit Counseling Organization

##### Counseling Sessions.

- (1) DEF's counselors ask clients to provide information on their income, assets, liabilities and expenses only to the extent necessary for the counselor to determine whether they qualify for a debt management plan;
- (2) DEF's counselors generally do not interview clients about their budget and finances except to the extent necessary to qualify the client for a debt management plan;
- (3) DEF's counselors generally only recommend debt management plans as a possible option. They generally do not describe other alternatives for addressing the client's financial problems, such as budgeting, negotiating directly with creditors or bankruptcy; and
- (4) DEF's counselors also provide to each person written materials on budgeting and managing personal finances and discuss these materials with them.

#### Counselor Education and Training.

- (1) DEF's counselors primarily receive training in marketing, qualifying for and establishing debt management plans. They receive only limited training in personal finance, budgeting, and credit and debt management; and
- (2) DEF evaluates and compensates its counselors, in part, on how many clients they sign up for debt management plans.

#### Outreach and Advertising.

- (1) DEF receives referrals from employers, union leaders, clergymen, community organizations or creditors;
- (2) DEF purchases lists of, and pays for referrals of, debtors, whom it contacts to offer services; and
- (3) DEF uses the Internet, phone solicitations, mass media and direct mail to advertise its counseling and debt management services. DEF's advertisements primarily promote debt management plans (based on prominence and relative amount of time and space devoted).

### LAW AND ANALYSIS

#### A. Educational Purposes

Section 501(c)(3) describes organizations operated exclusively for charitable, educational and other specified purposes. Treas. Reg. § 1.501(c)(3)-1(d)(2) defines the term charitable to include the advancement of education. Treas. Reg. § 1.501(c)(3)-

1(d)(3) defines the term educational as the instruction or training of the individual to improve or develop his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community. The regulation further provides that an organization may be educational even though it advocates a particular position or viewpoint, so long as it presents a sufficiently full and fair exposition of the pertinent facts to permit the public to form an independent opinion or conclusion. An organization is not educational if its principal function is the mere presentation of unsupported opinion. Treas. Reg. § 1.501(c)(3)-1(d)(3) (flush language).

#### B. Methodology Standard

*Big Mama Rag, Inc. v. Commissioner*, 494 F.Supp. 473, 479 n.6 (D.D.C. 1979), *rev'd and remanded*, 631 F.2d 1030 (D.C.Cir. 1980), considered whether an organization that published a newspaper devoted to feminist causes was educational within the meaning of § 501(c)(3) and Treas. Reg. § 1.501(c)(3)-1(d)(3). The district court held that the general educational standard in the first part of the regulation is “far too subjective in its application to pass constitutional muster.” The district court also held that the “full and fair exposition” part of the regulation was not unconstitutionally vague. It then applied the full and fair exposition standard to the organization and found that it was not educational. 494 F. Supp. at 480. The appellate court affirmed the district court’s holding that the general educational standard was unconstitutional. 631 F.2d at 1036. But the appellate court held that the “full and fair exposition” part of the regulation also was unconstitutionally vague, finding it so imprecise that it allowed “individual IRS officials to pass judgment on the content and quality” of the organization’s publications. 631 F.2d at 1040. The appellate court thereby reversed the district court’s holding that the organization was not educational.

According to *Big Mama Rag*, the Service may not judge whether ABC and DEF further educational purposes under § 501(c)(3) based on the content or quality of their publications or counseling sessions. Nevertheless, the appellate court made clear that its ruling did not mean the Service must accord tax-exempt status “to every organization claiming an educational mantle.” 631 F.2d at 1040. Rather, the Service must base its determination on “criteria capable of neutral application.” *Id.*

In *National Alliance v. United States*, 710 F.2d 868 (D.C.Cir. 1983), the Service first presented its methodology test for applying Treas. Reg. § 1.501(c)(3)-1(d)(3). The Service contended that an organization, which published newsletters and bulletins and held lectures and meetings inciting violence against certain racial, ethnic or religious groups and asserting common and dangerous traits by the members of such groups, was not educational under § 501(c)(3). 710 F. 2d at 872-873. The Service’s methodology test had four criteria, including whether the organization’s approach was aimed at developing an understanding by the audience, considering its background or training. 710 F. 2d at 874. The court stated that the methodology test’s “criteria tend toward ensuring that the educational exemption be restricted to material which

substantially helps a reader or listener in a learning process.” The court did not reach the question of whether the methodology test cured *Big Mama Rag*’s holding that Treas. Reg. § 1.501(c)(3)-1(d)(3) was unconstitutionally vague, finding that the organization’s publications were not “educational within any reasonable interpretation of the term.” 710 F.2d at 874-876. Based on that finding, the court upheld the Service’s determination that the organization was not furthering educational purposes.

Subsequent to *National Alliance*, the Service published Rev. Proc. 86-43, 1986-2 C.B. 729, which describes the methodology test the Service uses to determine when the advocacy of a particular viewpoint or position is educational for § 501(c)(3) purposes. The revenue procedure states that the focus of Treas. Reg. § 1.501(c)(3)-1(d)(3) is on the method the organization uses to communicate to others, not the content of its communication. The method of communication is not educational “if it fails to provide a development from the relevant facts that would materially aid a listener or reader in a learning process.” One factor indicating the method is not educational is as follows: “The approach used in the organization’s presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter.” The remaining factors relate specifically to advocacy organizations and the “full and fair exposition” part of the regulation and would not be applicable to credit counseling organizations.<sup>1</sup>

Following the publication of Rev. Proc. 86-43, *Nationalist Movement v. Commissioner*, 102 T.C. 558 (1994), *aff’d on other grounds*, 37 F.3d 216, 221 n.5 (5<sup>th</sup> Cir.) upheld the Service’s determination that an organization, which advocated for social, political and administrative change through its publications, did not further educational purposes within the meaning of § 501(c)(3). The Service applied the methodology test in Rev. Proc. 86-43, much as it had in *National Alliance*, concluding that the organization did not further educational purposes.<sup>2</sup> The court agreed, holding in part that the organization’s method was “not aimed at developing any understanding on the part of the intended audience or readership because it does not consider their specific background or training.” 102 T.C. at 583-584, 594.<sup>3</sup> The court found that the methodology test was not unconstitutionally vague or overbroad, nor was it unconstitutional as applied. 102 T.C. at 588-589. The court concluded that the test was “sufficiently understandable, specific and objective,” observing that it “focuses on the method rather than the content of the presentation.” *Id.* Therefore, based on *Nationalist Movement*, the Service may apply the methodology test to objectively determine whether ABC and DEF are educational within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(3)

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<sup>1</sup> The remaining factors are: (1) presenting viewpoints or positions unsupported by facts; (2) distorting the facts that purport to support the viewpoints or positions; and (3) using inflammatory and disparaging terms and conclusions based on strong emotional feelings rather than objective evaluations.

<sup>2</sup> Like *National Alliance*, the organization’s publications broadcast false, disparaging and incendiary remarks about various racial, ethnic and other groups. 102 T.C. at 564-568.

<sup>3</sup> The court also found that the organization’s publications stated positions unsupported by facts, distorted the facts and used inflammatory and disparaging terms. 102 T.C. at 591-593.

### C. Distinguishing Between ABC and DEF Based on Educational Methodology

ABC and DEF are distinguishable by the methodology they use to conduct their counseling activities. ABC's methodology establishes that it furthers educational purposes under § 501(c)(3), whereas DEF's methodology demonstrates that it does not.

ABC's counselors request detailed information on all sources of income, assets, liabilities and expenses. They interview clients on topics such as their budget and finances and the circumstances surrounding significant changes in their financial picture. ABC's counselors then present options and strategies that respond to the specific circumstances of each debtor. ABC's counselors are equipped to provide individually-tailored recommendations because they receive comprehensive training in personal finance and budgeting, developing options and recommendations and identifying underlying causes of the debtor's financial condition. ABC compensates and evaluates its counselors on how effectively they develop and present options that respond to the particular circumstances of each debtor. Finally, ABC's outreach and advertising primarily is structured to promote counseling services, rather than specific options, such as debt management plans. Thereby, the structure of ABC's counseling program helps each individual debtor develop a better understanding of his specific credit problems and learn how to address them. See *National Alliance*, 710 F.2d at 875; *Nationalist Movement*, 102 T.C. at 583-584; Rev. Proc. 86-43. Under these circumstances, ABC primarily is furthering educational purposes.

On the other hand, DEF's counseling program is not structured primarily to improve its clients' understanding of their financial problems or their skills in solving them. Instead, DEF's counselors primarily promote a specific option, *i.e.*, debt management plans, without considering whether it is appropriate in light of each client's individual circumstances. DEF's counselors are not equipped to develop a range of personalized options for clients, because their training concentrates on marketing debt management plans. Further, DEF's counselors are evaluated and compensated in part based on how many clients they enroll in debt management plans. Finally, DEF's outreach and advertising concentrates on promoting debt management plans and identifying individuals who will qualify for them. The failure to describe options other than debt management plans in most cases, the compensation arrangement for counselors and the structure of the outreach efforts collectively indicate that DEF's goal is to promote debt management plans. Moreover, these facts, combined with the failure to get a valid picture of the client's financial circumstances, indicate that DEF is not making efforts to improve its clients' understanding of the causes of, and alternatives for addressing, their financial problems. See *National Alliance*, 710 F.2d at 875; *Nationalist Movement*, 102 T.C. at 583-584; Rev. Proc. 86-43. DEF, therefore, does not primarily further educational purposes.



#### D. Other Factors

The fact that ABC is governed by a community-based board, which is independent of creditors, provides additional support for the conclusion that ABC operates primarily for exempt purposes. See *Consumer Credit Counseling Service of Alabama v. United States*, 78-2 U.S. Tax. Cas. (CCH) ¶ 9660 (D.D.C. 1978) (60% of directors were representative of the general public); Rev. Rul. 69-441 (board was representative of religious organizations, civic groups, labor unions, business groups and educational institutions). By comparison, the fact that DEF is governed by a community-based board, though a favorable factor standing on its own, is not sufficient to overcome the weight of other factors (discussed above and below) establishing that DEF does not operate primarily in furtherance of exempt purposes.

Because ABC employs a counseling methodology that furthers educational purposes, ABC need not limit its services to a charitable class to qualify for exemption. See *Consumer Credit Counseling Service of Alabama, supra* (organization that provided counseling and debt management services to the general public was educational). However, because of DEF's approach to counseling, DEF does not further educational purposes. In light of the fact that DEF does not limit its counseling and debt management plan services to a charitable class, but instead makes its services available to the general public, DEF cannot claim that its activities further charitable purposes. Compare Rev. Rul. 69-441, 1969-2 C.B. 115 (organization limited its counseling and establishment of budget plans to low-income individuals and families with financial problems), with Rev. Rul. 65-299, 1965-2 C.B. 165 (organization did not engage in any educational activities and did not limit assistance to proper recipients of charity).

Further, under these facts and circumstances, ABC may provide debt management plans as a substantial part of its activities without loss of exemption. See *Consumer Credit Counseling Service of Alabama, supra* (debt management services were an adjunct to, and an integral part of, its exempt counseling function). Like *Alabama*, ABC's counseling activities are a substantial part of its activities, and they further exempt educational purposes. ABC conducts its debt management plan activities only in conjunction with its exempt educational counseling function. Before making any recommendations, ABC first requests detailed information about a client's income, assets, liabilities and expenses and conducts a wide-ranging interview about the client's budget and finances. It will recommend and establish a debt management plan for a client only if it determines that a debt management plan is best suited to meet the clients' individual needs, goals and circumstances. It also will discuss with each client the advantages and disadvantages of debt management plans and other options it recommends. ABC establishes debt management plans only for its counseling clients. Finally, ABC provides follow-up counseling to clients as appropriate after the initial intake interview. Based on all the facts and circumstances, ABC's debt management services are integral to, and an adjunct of, its exempt credit counseling function. In comparison, DEF's counseling activities do not further either charitable or educational

purposes. Therefore, under the circumstances, DEF's debt management services are not integral or incidental to the performance of a primary exempt function and do not, thereby, further charitable or educational purposes. See *Consumer Credit Counseling Service of Alabama, supra*.

Finally, absent other facts indicating that ABC operates for the private benefit of creditors, ABC may receive contributions from creditors, including fair share payments, without loss of exemption. See *Consumer Credit Counseling Service of Alabama, supra* (organization furthering charitable and educational purposes received substantial contributions from creditors); Rev. Rul. 69-441 (receipts of charitable and educational organization primarily came from creditors participating in its budget plans). Similarly, the fact that DEF receives fair share payments and other contributions from creditors, standing alone, does not provide a basis for denying exemption to DEF.

### CASE DEVELOPMENT

In each case, the facts should be developed with respect to how the organization (1) counsels its clients, (2) trains and evaluates its counselors, and (3) conducts its outreach and advertising. You should fully develop each of the individual facts we have presented with ABC and DEF. The presence (or absence) of these facts will enable you to determine whether the method or structure by which a credit counseling organization conducts its counseling programs is educational. If, after fully developing these facts, you find that the organization primarily furthers educational purposes, like ABC, your examination or determination should be closed favorably (absent a showing of inurement or substantial private benefit). On the other hand, if you conclude that the organization does not further either charitable or educational purposes, like DEF, revocation or denial of § 501(c)(3) status is appropriate.

### LITIGATION CONSIDERATIONS

The courts have not fully developed the methodological analysis or applied such analysis to credit counseling or similar educational organizations. To date, the cases have been limited to educational organizations that advocate a particular position or viewpoint, cases which primarily implicate the full and fair exposition part of Treas. Reg. § 1.501(c)(3)-1(d)(3). In two of these cases, the organizations disseminated incendiary and patently false statements. See *National Alliance, supra*; *Nationalist Movement, supra*.

Additionally, the regulations define the term educational broadly, and the courts have interpreted the term expansively. Both the courts and the Service have concluded that credit counseling organizations may further educational purposes. See *Consumer Credit Counseling Service of Alabama, supra*; Rev. Rul. 69-441. Nevertheless, the methodology standard is objective, and the courts have recognized that it overcomes the unconstitutional application and interpretation of Treas. Reg. § 1.501(c)(3)-1(d)(3).

[REDACTED]

The methodology test also provides you a legal basis for targeting your examination and determination resources to ascertain whether an organization qualifies for exemption.

[REDACTED]

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