



Protecting Your Nonprofit Housing Counseling Agency's 501(c)(3) Status

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Agenda

- What the IRS is doing
- What agencies can expect
- The legal requirements for 501(c)(3) status
- Recent IRS treatment of housing counseling agencies
- How to prepare for the IRS Housing Counseling Compliance Project
- What to do if your agency is selected



What Is the IRS Doing?:

The Housing Counseling and Foreclosure Prevention Compliance Project



What the IRS Is Doing

- The IRS has begun a “compliance project” relating to the tax-exempt housing counseling and foreclosure prevention industry.
- On January 28, 2013, the IRS Director of Exempt Organizations released the *IRS Exempt Organizations FY 2012 Annual Report & FY 2013 Workplan* setting forth the 2013 IRS focus areas.
 - Including “on organizations that offer or propose to offer foreclosure assistance activities.”
 - According to the IRS, there has been an increase in the number of organizations claiming to help individuals facing foreclosure, but many of these organizations closely resemble the noncompliant organizations that claimed to offer credit counseling support.



What the IRS Is Doing

- Housing Counseling and Foreclosure Prevention Compliance Project.
 - The IRS has assembled a working group that is comprised of many of the same individuals who oversaw the Credit Counseling Compliance Project between 2004 and 2012.
 - The IRS has already identified 280 organizations which will be subject to an IRS compliance reviews and, where appropriate, an IRS examination—not a matter of “if,” but a matter of “when”—for 280 organizations.



What Can Agencies Expect?:

The Impact of the Housing Counseling and Foreclosure Prevention Compliance Project on your Agency



Impact of the Compliance Project— Revocation

- The **REVOCATION** of the tax-exempt status of a substantial portion of the industry.
 - The Workplan specifically mentioned similarities between this project and the Credit Counseling Compliance Project.
 - The compliance project team is comprised of many of the same individuals who were on the credit counseling compliance project team.

- The IRS has at various times publicly stated that the credit counseling compliance project resulted in the revocation or proposed revocation of 80% of the industry.



Impact of the Compliance Project— Impact of Revocation

- Federal and state tax-exempt status (state tax-exempt status will vary depending upon state)
- HUD-approval status
 - Government and foundation grant eligibility
 - Ability to solicit tax-deductible charitable contributions
 - Exemptions from various statutes (*e.g.*, Federal Trade Commission Act, federal and state credit repair statutes, state mortgage foreclosure consulting statutes).
 - Loss of ability to participate in CFPB Mortgage Rules (Disclosures and Mandatory Housing Counseling Requirements)



Legal Requirements:

The Legal Standards of the Housing Counseling and Foreclosure Prevention Compliance Project



Legal Requirements for 501(c)(3) Status

- General Code section 501(c)(3) requirements
 - Charitable mission
 - Public, not private, benefit
 - No inurement
- Additional Code section 501(q) requirements



Legal Requirements—501(c)(3)

- Charitable Mission
 - Section 501(c)(3) organizations must be organized and operated primarily for a charitable purpose
 - Religious, charitable, scientific, educational, testing for public safety, literary, relieving the burdens of government, etc.

- Housing counseling organizations:
 - Education
 - Relief of financially distressed individuals
 - Relief of the burdens of government



Legal Requirements—501(c)(3)

- No Private Benefit
 - Generally, tax-exempt organizations are required to limit their activities to those that further their stated mission
 - A non-exempt purpose is generally a purpose that serves a private rather than a public benefit, as such, is generally called a “private benefit”
 - Provision of an impermissible private benefit is grounds for revocation



Legal Requirements—501(c)(3)

- No inurement
 - Code generally provides that no part of organization’s net earnings can inure to the benefit of any private individual or shareholder
 - Penalty for inurement is REVOCATION



Legal Requirements—501(q)

- *In addition to* meeting all current legal requirements contained in Section 501(c)(3), a credit counseling agency desiring tax-exempt status under Section 501(c)(3) *also* must adhere to the rules contained in Section 501(q).
- If 501(q) applies to your housing counseling agency, then any violation of any 501(q)'s requirements and prohibitions will result in loss of 501(c)(3) status.



Legal Requirements—501(q)

- “Credit Counseling Services” Defined:
 - Section 501(q) is generally applicable to all organizations exempt under Sections 501(c)(3) or (4) that provide “credit counseling services” as a “substantial purpose” of their organization.
 - “Credit counseling services” are defined as (i) the providing of educational information to the general public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of consumer credit, (ii) the assisting of individuals and families with financial problems by providing them with counseling, or (iii) a combination of the above.



Legal Requirements—501(q)

- March 30, 2010 IRS Chief Counsel Advice Memorandum
 - First published IRS guidance regarding 501(q)
 - Concludes that organizations that provide educational information on financial topics or provide financial counseling to homeowners who are at risk of foreclosure are providing “credit counseling services” within the meaning of 501(q). An organization that engages in such activities as a “substantial purpose” must comply with 501(q).



Legal Requirements—501(q)

- Services Tailored to Consumers:
 - You must provide credit counseling services tailored to the specific needs and circumstances of each consumer.

- Loans:
 - You may not make loans to debtors (other than loans with no fees or interest) and you may not negotiate the making of loans on behalf of debtors.



Legal Requirements—501(q)

- Credit Repair:
 - You may only provide incidental services to improve consumer credit records and credit history, and you may not charge a separate fee for such services.

- Ability to Pay:
 - You may not refuse services based on inability to pay, or on the ineligibility or unwillingness of a consumer to enroll in a debt management plan.



Legal Requirements—501(q)

- Fee Policy:
 - You may charge reasonable fees, but must provide waivers if a consumer is unable to pay; also, except to the extent allowed by state law, you may not charge fees based on the percentage of the consumer's debt, the consumer's debt management plan payments, or the savings to the consumer from the debt management plan.



Legal Requirements—501(q)

■ Board Composition:

- The majority of your board of directors must represent the broad interests of the public, such as public officials, community leaders, and persons having special knowledge or expertise in credit or financial education.
- No more than 49% of the board may be employees of the agency, creditors or others who will benefit financially (directly or indirectly) from the agency's activities (other than through reasonable directors' fees), *and* no more than 20% of the board may be employees of the agency or others who will benefit financially (directly or indirectly) from the agency's activities (other than through reasonable directors' fees or the repayment of consumer debt to creditors).



Legal Requirements—501(q)

- Ownership of Subsidiaries:
 - You may not own more than a 35% interest in a non-501(c)(3) entity that is in the business of lending money, repairing credit, or providing debt management plan services, payment processing, or similar services.



Legal Requirements—501(q)

■ Referrals:

- You may not pay for obtaining referrals of consumers (for any purpose), and you may not receive compensation for providing referrals to others for debt management plan services. Note that the legislative history makes clear that if an agency pays or receives a fee for using or maintaining a locator service for consumers to find a credit counseling agency, this is not considered a referral.



Legal Requirements—501(q)

- Soliciting Contributions:
 - You may not solicit contributions during the initial counseling process or while the consumer is receiving services from you.



Legal Requirements—501(q)

- Limitations on Revenue from Creditors:
 - Section 501(q) limits revenues from creditors (e.g., banks, mortgage servicers) that are attributable to “debt management plan services.”
 - Currently, such payments from creditors cannot exceed 50% of your total revenues.



Legal Requirements—501(q)

- “Debt management plan services”
 - defined as services related to the repayment, consolidation or restructuring of a consumer’s debt, and includes the negotiation with creditors of lower interest rates, the waiver or reduction of fees, and the marketing and processing of debt management plans.



The Impact of 501(q)

- Impact of applicable percentage requirements
 - The IRS' conclusion in the Chief Counsel Advice Memorandum that certain housing counseling negotiation services constitute “debt management plan services” means that an agency's total revenues from creditors (attributable to “debt management plan services”) cannot exceed 50 percent of total revenues. In other words, if such revenues from mortgage lenders, servicers and the like exceed 50 percent of all revenue, 501(c)(3) status will be forfeited.



The Impact of 501(q)

- Housing counseling DOES NOT equal the negotiation or making of loans.
 - The IRS Chief Counsel Advice Memorandum concludes that the provision of housing counseling – including attempts to request repayment options, modify the terms of existing mortgages, modify interest rates, amortize amounts in default, and/or modify the period for paying off a mortgage – will not violate 501(q)'s prohibition on making loans to debtors and on negotiating the making of loans on behalf of debtors. These services are permissible “debt management plan services.”
 - Distinguishes new loans from modifications of existing loans.



The Impact of 501(q)

- Refinancing-related counseling:
 - Does assisting a homeowner with a refinancing trigger the loan negotiation prohibition of 501(q), as refinancing involve the making of a new loan?
 - Chief Counsel Advice Memorandum author says it is not the IRS' intention to treat refinancing-related counseling differently than modification-related counseling, although “the statute is not a model of clarity.”



The Impact of 501(q)

- Impact on agencies that offer mortgages
 - 501(q) makes clear that covered housing counseling agencies cannot make loans to consumers.
 - As such, covered agencies that offer loans may need to organize a separate affiliate for such activities. Note that the legislative history of 501(q) (*i.e.*, a report prepared by the Joint Committee on Taxation) states that “organizations that provide assistance to consumers to obtain a loan from the Department of Housing and Urban Development, for example, are not necessarily negotiating a loan for a consumer.”



The Impact of 501(q)

- Non-foreclosure, housing counseling
 - While it does address foreclosure prevention counseling, the IRS Chief Counsel Advice Memorandum does not address other forms of HUD-approved housing counseling services, such as pre-purchase or reverse mortgage counseling.
 - Both would seem to trigger the definition of “credit counseling services,” but revenues from creditors in connection with such counseling (if any) may not be subject to the 50-percent limitation.



Recent IRS Treatment of Housing Counseling Agencies and What Can Be Learned



Recent IRS Treatment of Housing Counseling Agencies

- Recently published IRS rulings
- Trends in the recent IRS rulings
- Lessons from the recent IRS rulings



Recent IRS Rulings

- Three published determinations in February—all three denials of recognition of tax-exempt status—PLR 201305013 (2/2/13); PLR 201307014 (2/15/13); and PLR 201307015 (2/15/13).

- IRS basis for determinations:
 - No charitable class served;
 - Operated as a taxable entity;
 - Private benefit; and
 - Violation of the board composition requirements of 501(q).



Trends in Recent IRS Rulings

- Trends in the recent rulings:
 - All denials of exempt status recognition
 - The IRS is being very aggressive in developing issues and interpreting the law:
 - Denials were based on unsupported (and unnecessary) extensions of the scope of legal authority (PLR 201307015)
 - Certain legal arguments were made as assumptions
 - Very similar to the beginnings of the credit counseling compliance project.
 - Section 501(q) will likely be deemed to be applicable to your organization—(PLR 201307015) the provision of a single two-hour counseling session was sufficient for application of 501(q).



Lessons from Recent IRS Rulings

- Be prepared for the IRS to be aggressive.
- Expect the IRS to apply Code section 501(q).
- The IRS will be very skeptical of transactions between 501(c)(3) organizations and related parties.
- The IRS may be skeptical of the educational value of foreclosure prevention counseling—in PLR 201305013, without explanation, the IRS said that foreclosure prevention counseling is not educational.
- The IRS will be focused on board and officer compensation.



How Your Agency Can Prepare for the IRS Compliance Project



How to Prepare for a Compliance Project

- Learn about the legal requirements that must be met to be recognized as tax-exempt.
- Understand your activities, your risks, and what your agency has reported to the IRS in its annual Forms 990.
- If you may have issues, ask now—not later.
- Understand the current regulatory environment when developing new programs.



How to Prepare—Learn

- Participating in this presentation is a good start
- See Venable articles, alerts and presentations... we are constantly adding information:

www.Venable.com/ccds/publications

www.Venable.com/ccds/events

- Do not limit your reading to housing counseling; also read about the credit counseling compliance project, because we expect to see many similarities.



How to Prepare—Learn about Your Organization

- Form 990
 - Before the IRS conducts an examination, the agent will study your organization’s annual Form 990, and information that you provide in response to a compliance check will be compared to the Forms 990 on file with the IRS—you should do the same before the compliance questionnaire arrives.
 - Comparing your own Form 990 to the Forms 990 of other agencies will give you an idea of potential issues—compare your Form 990 to those of the seemingly most compliant organizations.

- Understand your agency’s purpose and think about how to explain your purpose.



How to Prepare—Ask

- Rely on the best experts—experience counts.
- If you are even the slightest bit concerned that you may have an issue... **ASK BEFORE THE IRS SHOWS UP**
 - It is cheaper to resolve tax issues before the IRS shows up.
 - The IRS is more likely to respect changes that take place before the IRS shows up.
- If you have several potential issues, we recommend a ***mock IRS audit.***



How to Prepare—Consider Regulatory Environment

- Evaluate all *new* potential programs, activities and revenue against the current regulatory environment, and structure initiatives accordingly to manage and mitigate tax and regulatory risk.
- Evaluate all *existing* programs, activities and revenue sources in the same manner.
- Work proactively and collaboratively with both in-house and outside legal counsel in this regard.



What to Do if Your Agency Receives an IRS Compliance Check Questionnaire



What to Do, How to Respond

- The compliance check questionnaire will be an information request that arrives in the U.S. mail.
- A compliance check is not an “IRS examination,” but it may become an examination later, especially depending on how the compliance check is handled.



What to Do, How to Respond

- How to respond:
 - YOU MUST RESPOND!
 - Respond honestly—must be signed under the penalties of perjury.
 - Do not treat this as a “form” or as a true false exam.
 - Do not simply answer the questions:
 - Answer the questions in the manner that best demonstrates your agency’s exempt mission; and
 - Answer the questions with an eye to what information the IRS is trying to obtain.



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