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Housing Counseling Agencies and Internal Revenue Code Section 501(q): What the New IRS Guidance Means for the Housing Counseling Industry

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Introduction:

- * How did we get here?
- * Did Congress intend for Section 501(q) to apply to housing counseling agencies?
 - * The law of unintended consequences
 - * What does this all mean for housing counseling agencies?



This presentation is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to specific fact situations.

How 501(q) Relates to Existing IRS Requirements:

- *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.

Why 501(q) Matters:

- Federal and state tax-exempt status
- 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)



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“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.

501(q)'s Requirements and Prohibitions



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Services Tailored to Consumers:

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



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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.



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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.



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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.



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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.

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).

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Ownership:

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



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 a credit counseling 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.

Soliciting Contributions:

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



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Limitation on Revenues from Creditors:

- Section 501(q) limits revenues from creditors (e.g., banks, mortgage servicers) that are attributable to “debt management plan services.” Such payments from creditors cannot exceed 50% of your total revenues; however, for credit counseling agencies that were in existence on 8/17/06, the 50% limit phases in over four years. (For an existing agency with a calendar year tax year, the phase-in percentage is 60% for 2010; 50% in 2011).

“Debt Management Plan Services” Defined:

- “Debt management plan services” are 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.



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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).

Housing Counseling Does Not Equal Negotiating the 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.

What the Limit on Revenues from Creditors Means for Housing Counseling Agencies

- The IRS' conclusion 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.

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.”



What about Agencies that Offer Mortgage Loans?

- 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.”

What about Other Types of 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.

Private Benefit to Creditors

- The IRS Chief Counsel Advice Memorandum recognizes two earlier CCA Memoranda regarding credit counseling agencies, and states that 501(q) “does not diminish the requirements set forth [in the two memos] but builds on and is consistent with such requirements.” The Memorandum’s author noted the ban on impermissible private benefit to creditors as an example. Housing counseling agencies must remain mindful of this consideration.

Checklist

- Are you engaged in credit counseling services as a substantial purpose?
If so, 501(q) requirements:
 - Loans
 - Credit repair
 - Ability to pay
 - Board composition
 - Ownership
 - Referrals
 - Contributions
 - Debt management plan services revenue limit

- IRS Form 990 credit counseling services (Part IV, Line 9 and Schedule D, Part IV)

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QUESTIONS

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