

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

CC:TEGE:EOEG:EO2:DLMarshall  
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date: March 30, 2010

to: Steven Grodnitzky  
Acting Manager, EO Technical  
SE:T:EO:RA:T

from: Philip T. Hackney  
Senior Technician Reviewer  
CC:TEGE:EOEG:EO2

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subject: Application of Section 501(q) to Organizations Assisting Homeowners Who Are at Risk of Foreclosure

This memorandum responds to your request for assistance regarding the possible application of § 501(q) of the Internal Revenue Code to existing organizations exempt from federal income tax under § 501(c)(3) or (4) and applicants for tax-exempt status under § 501(c)(3) or (4) that are engaging, or are proposing to engage, in activities that assist homeowners who are at risk of foreclosure.

This advice may not be used or cited as precedent.

**ISSUES**

1. Whether organizations that provide educational information on financial topics or financial counseling to homeowners who are at risk of foreclosure are providing "credit counseling services" within the meaning of § 501(q)(4)(A), making them potentially subject to the requirements of section 501(q)?
2. If such organizations are subject to the requirements of § 501(q), are they in violation of the prohibition on the "negotiating the making of a loan" within the meaning of § 501(q)(1)(A)(ii) if such organizations contact holders or servicers of homeowners' mortgages to try to modify the terms of such mortgages to enable individuals to avoid foreclosure?

**CONCLUSIONS**

1. 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)(4)(A). An organization that engages in such activities as a substantial purpose must, in addition to complying with the requirements of § 501(c)(3) or (4), comply with the provisions of § 501(q).

2. Organizations that assist homeowners who are at risk of foreclosure by providing financial counseling and/or providing educational information to the general public on financial topics as a substantial purpose are not in violation of the prohibition contained in § 501(q)(1)(A)(ii) regarding the "negotiating the making of a loan," where the organizations contact holders or servicers of homeowners' mortgages to try to modify the terms of such mortgages so that individuals might avoid foreclosure.

### BACKGROUND

In the current economic climate, mortgage foreclosures have increased significantly. Many tax-exempt and non-exempt organizations have entered the field of providing assistance to those in danger of home foreclosure.

A number of these organizations have filed a Form 1023, Application for Recognition of Exemption Under § 501(c)(3) of the Internal Revenue Code, with your office, to be recognized as organizations described in § 501(c)(3). Additionally, we understand that a number of organizations already recognized as organizations described in § 501(c)(3) or § 501(c)(4) are conducting such activities. You have asked us whether § 501(q) applies to these organizations, and if so, what effect § 501(q) has on these applications or on existing organizations.

We understand that these organizations assist homeowners at risk of foreclosure by (1) educating such homeowners on financial topics by conducting seminars, public discussion groups, forums, panels, lectures, or workshops, or by otherwise disseminating financial educational material to these homeowners and/or (2) providing financial counseling to such homeowners.

In addition, these organizations sometimes contact, or assist borrowers in contacting, the holders or servicers of mortgages to request repayment options or to modify the terms of existing mortgages to prevent foreclosure. They may attempt to modify the interest rate, amortize the amount in default, and/or modify the time period for paying off a mortgage.

### LAW

Section 501(c)(3) 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 501(c)(4) provides for the exemption from federal income tax for nonprofit organizations operated exclusively for the promotion of social welfare.

Section 501(q) imposes requirements on organizations otherwise described in § 501(c)(3) or (4) if "the provision of credit counseling services is a substantial purpose."

Section 501(q)(1)(A)(ii) provides that an organization with respect to which the provision of credit counseling services is a substantial purpose must be an organization that makes “no loans to debtors (other than loans with no fees or interest) and does not negotiate the making of loans on behalf of debtors.” (Emphasis added)

Section 501(q)(2)(A)(ii) provides that if an organization is described in section 501(c)(3) and is providing credit counseling services as a substantial purpose, it may be exempt only if its aggregate revenues from payments by creditors of consumers of the organization attributable to debt management plan services do not exceed a specified percentage of total revenues.

Section 501(q)(4)(A) defines, for purposes of § 501(q), the term “credit counseling services” to mean (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 activities described in clauses (i) and (ii).

Section 501(q)(4)(B) defines, for purposes of § 501(q), the term “debt management plan services” to mean 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 Internal Revenue Service (IRS) issued two Chief Counsel Advice (CCA) memoranda regarding credit counseling organizations. Chief Counsel Advice 200431023 (July 13, 2004) discusses the background and overall legal framework to use in developing credit counseling cases. In this CCA, the IRS analyzed issues concerning substantial non-exempt purpose, private inurement, private benefit, the unrelated business income tax, and claims for exemption under § 501(c)(4). Chief Counsel Advice 200620001 (May 9, 2006) specifically describes the legal framework for determining whether a credit counseling organization primarily furthers educational purposes and provides counseling.

Although these two CCAs were issued before the enactment of § 501(q), as the Joint Committee on Taxation stated, these two CCA “provide a legal framework for determining exempt status and related issues with respect to credit counseling organizations.”<sup>1</sup> The Joint Committee further stated that § 501(q) “does not diminish the requirements set forth [in the two CCAs] but builds on and is consistent with such requirements, and the analysis therein.”<sup>2</sup>

## ANALYSIS

1. Organizations that provide educational information on financial topics or provide financial counseling to homeowners at risk of foreclosure are providing “credit counseling services” within the meaning of § 501(q)(4)(A). An organization that

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<sup>1</sup> Staff of the Joint Committee on Taxation, 108<sup>th</sup> Cong., 2d Sess., Technical Explanation of H.R. 4, The “Pension Protection Act of 2006,” (Comm. Print JCX-38-06) 315 (“Technical Explanation”).

<sup>2</sup> Technical Explanation at 316.

engages in such activities as a substantial purpose must, in addition to complying with the requirements of § 501(c)(3) or (4), comply with the provisions of § 501(q).

Section 501(q)<sup>3</sup> was enacted as part of the Pension Protection Act of 2006 (Public Law 109-280) to apply special rules to “credit counseling organizations” that are otherwise exempt from federal income tax under § 501(a) as organizations described in § 501(c)(3) or (4). Thus, to be exempt, in addition to meeting the requirements of § 501(c)(3) or (4), a credit counseling organization must demonstrate that it meets the requirements of § 501(q). As defined in § 501(q), credit counseling organizations are those organizations for which the provision of credit counseling services is a substantial purpose. The term “credit counseling services,” is defined in § 501(q) to mean:

“(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 activities described in clauses (i) and (ii).”

§ 501(q)(4)(A)(i),(ii) and (iii).

As described in the Background section above, organizations assisting homeowners who are at risk of foreclosure (1) educate such homeowners on financial topics by conducting seminars, public discussion groups, forums, panels, lectures, or workshops, or by otherwise disseminating financial educational material to these homeowners, and/or (2) provide financial counseling to such homeowners. Because these activities constitute the provision of educational information to the general public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of consumer credit, and/or the assisting of individuals with financial problems through counseling, they fall within the definition of “credit counseling services” under § 501(q)(4)(A). Organizations that conduct such activities as a substantial purpose of their operations are required to comply with the provisions of § 501(q).

2. Organizations that assist homeowners who are at risk of foreclosure by providing financial counseling and/or providing educational information to the general public on financial topics as a substantial purpose are not in violation of the prohibition contained in § 501(q)(1)(A)(ii) where the organizations contact holders or servicers of homeowners’ mortgages to try to modify the terms of such mortgages so that individuals might avoid foreclosure.

Section 501(q)(1)(A)(ii) provides that a credit counseling organization may not make “loans to debtors (other than loans with no fees or interest)” and may “not negotiate the making of loans on behalf of debtors.” (Emphasis added)

You asked whether acting as an intermediary between a borrower who is at risk of foreclosure and a holder or servicer of the mortgage in an attempt to renegotiate the

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<sup>3</sup> Section 501(q) is effective generally for tax years beginning after August 17, 2006.

terms of the borrower's mortgage, for instance, by requesting a reduction in the interest rate, the amortization of the amount in default, and/or a modification of the time period for paying off the loans, would be considered negotiating the making of a loan for purposes of § 501(q). We believe an organization serving as such an intermediary is not negotiating the making of a loan.

The exemption requirements of § 501(q) apply to organizations that provide credit counseling services as a substantial purpose. § 501(q)(1). Such organizations are permitted to engage in debt management plan services, as long as the attributable revenue from payments of creditors of consumers of the organization stays below specified limits for any such organization that is seeking exemption under § 501(c)(3). § 501(q)(2). Debt management plan services are services related to the "repayment, consolidation, or restructuring of a consumer's debt, and [include] the negotiation with creditors of lower interest rates [and] the waiver or reduction of fees." § 501(q)(4)(B). The language of § 501(q)(4)(B) describes quite specifically the service as an intermediary about which you have inquired. The language describes a circumstance where a loan already exists, and the borrower is seeking to modify it in response to exigent circumstances. As debt management plan services are something a credit counseling organization is permitted to provide under § 501(q), subject to the limitation on attributable revenue for § 501(c)(3) organizations, the statute must intend for debt management plan services to be distinct from negotiating the making of a loan, a service that a credit counseling organization is not permitted to provide.

For purposes of § 501(q), where the services an organization provides are debt management plan services, performed on behalf of borrowers at risk of foreclosure, the services would not be considered to be negotiating the making of a loan. Thus, credit counseling organizations will not be considered to negotiate the making of a loan to the extent they are helping individuals at risk of foreclosure to restructure the terms of their existing mortgages rather than negotiating a new loan.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

To be tax-exempt, an organization that engages in credit counseling services as a substantial purpose must meet all of the requirements of either § 501(c)(3) or § 501(c)(4), as well as the applicable requirements of § 501(q). The determination of whether any such organization meets those requirements will depend on all the facts and circumstances of each particular case.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-1124 if you have any further questions.