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IRS to Focus on Housing Counseling Agencies

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Earlier this year, the Internal Revenue Service's ("IRS") Exempt Organizations ("EO") division unveiled its annual work plan. The plan highlights EO's priorities for the year and is the best indicator of what the staff will be focused on in its determinations and examinations activities. These areas of focus were recently reiterated in remarks at a tax-exempt organizations conference attended by IRS EO staff.

One of the plan's six general work areas is of special interest to credit and housing counseling agencies.

The plan calls out the increasing challenges confronted by the IRS, as residential foreclosures have mounted and the number of exempt organizations involved in foreclosure assistance activities has increased. See page 11 of the IRS's FY 2012 Work Plan available on the IRS website by **clicking here**.

According to the report, in FY 2012, both EO's Determinations and Examinations offices will focus on the activities of mortgage foreclosure assistance organizations to determine whether they are fulfilling their exempt purpose, and whether they are complying with the requirements of section 501(q) of the Internal Revenue Code (the "Code").

Section 501(q) of the Code, added by the Pension Protection Act of 2006, establishes additional standards that a credit counseling organization must satisfy to qualify for exemption under section 501(c)(3) or 501(c)(4). Of particular relevance, in 2010, the IRS Office of Chief Counsel issued a memorandum concluding that organizations that engage in housing counseling may be subject to Code section 501(q).

The FY 2012 Work Plan and recent off-the record comments by IRS staff confirm that the IRS will be closely reviewing applications of would-be exempt organizations and the ongoing operations of existing groups that provide mortgage foreclosure assistance services.

Beginning in 2004, the IRS began scrutinizing tax-exempt credit counseling agencies in a manner and scope it never had previously. Since then, the IRS has initiated over 254 audits of credit counseling agencies. While the credit counseling compliance project is nearly complete and many organizations survived the process with their tax-exempt status intact, the IRS is now poised to focus on the activities of housing counseling agencies. Many of the same organizations that were audited as part of the credit counseling compliance initiative may be scrutinized all over again, along with several that escaped scrutiny due to their non-involvement in areas related to debt management plans for repayment of unsecured credit card debt.

In an audit, the IRS examines Form 990 returns to verify the correctness of the income or gross receipts, deductions, and credits, and to determine that the organization is operating in the manner stated and for the purposes set forth in its application for recognition of tax exemption.

Fortunately, a well-informed housing counseling agency can go a long way toward preparing for an IRS audit. While the advice and guidance of counsel is recommended in formulating and implementing an audit response and ongoing compliance with the Code, existing IRS-provided guidance in this area – which is quite extensive – and the lessons learned during the credit counseling compliance initiative can help a mortgage foreclosure assistance service provider conduct a "mock" IRS audit to identify areas of weakness from a tax-exemption perspective, as well as to suggest corrective measures.

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