TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006," AS PASSED BY THE HOUSE ON JULY 28, 2006, AND AS CONSIDERED BY THE SENATE ON AUGUST 3, 2006

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

August 3, 2006
JCX-38-06

Qualified appraisals

The provision defines a qualified appraisal as an appraisal of property prepared by a qualified appraiser (as defined by the provision) in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Secretary.

Effective Date

The provision amending the accuracy-related penalty applies to returns filed after the date of enactment. The provision establishing a civil penalty that may be imposed on any person who prepares an appraisal that is to be used to support a tax position if such appraisal results in a substantial or gross valuation misstatement applies to appraisals prepared with respect to returns or submissions filed after the date of enactment. The provisions relating to appraiser oversight apply to appraisals prepared with respect to returns or submissions filed after the date of enactment. With respect to any contribution of a qualified real property interest which is a restriction with respect to the exterior of a building described in section 170(h)(4)(C)(ii) (currently designated section 170(h)(4)(B)(ii), relating to certain property located in a registered historic district and certified as being of historic significance to the district), and any appraisal with respect to such contribution, the provision generally applies to returns filed after July 25, 2006.

10. Establish additional exemption standards for credit counseling organizations (secs. 501 and 513 of the Code)

Present Law

Under present law, a credit counseling organization may be exempt as a charitable or educational organization described in section 501(c)(3), or as a social welfare organization described in section 501(c)(4). The IRS has issued two revenue rulings holding that certain credit counseling organizations are exempt as charitable or educational organizations or as social welfare organizations.

In Revenue Ruling 65-299,[414] an organization whose purpose was to assist families and individuals with financial problems, and help reduce the incidence of personal bankruptcy, was determined to be a social welfare organization described in section 501(c)(4). The organization counseled people in financial difficulties, advised applicants on payment of debts, and negotiated with creditors and set up debt repayment plans. The organization did not restrict its services to the poor, made no charge for counseling services, and made a nominal charge for certain services to cover postage and supplies. For financial support, the organization relied on voluntary contributions from local businesses, lending agencies, and labor unions.

[414] Rev. Rul. 65-299, 1965-2 C.B. 165.

In Revenue Ruling 69-441,[415] the IRS ruled an organization was a charitable or educational organization exempt under section 501(c)(3) by virtue of aiding low-income people who had financial problems and providing education to the public. The organization in that ruling had two functions: (1) educating the public on personal money management, such as budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications; and (2) providing individual counseling to low-income individuals and families without charge. As part of its counseling activities, the organization established debt management plans for clients who required such services, at no charge to the clients.[416] The organization was supported by contributions primarily from creditors, and its board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

In 1976, the IRS denied exempt status to an organization, Consumer Credit Counseling Service of Alabama, whose activities were distinguishable from those in Revenue Ruling 69-441 in that (1) it did not restrict its services to the poor, and (2) it charged a nominal fee for its debt management plans.[417] The organization provided free information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the use of consumer credit. It also provided counseling to debt-distressed individuals, not necessarily poor or low-income, and provided debt management plans at the cost of $10 per month, which was waived in cases of financial hardship. Its debt management activities were a relatively small part of its overall activities. The district court determined the organization qualified as charitable and educational within section 501(c)(3), finding the debt management plans to be an integral part of the agency's counseling function, and that its debt management activities were incidental to its principal functions, as only approximately 12 percent of the counselors' time was applied to such programs and the charge for the service was nominal. The court also considered the facts that the agency was publicly supported, and that it had a board dominated by members of the general public, as factors indicating a charitable operation.[418]

A recent estimate shows the number of credit counseling organizations increased from approximately 200 in 1990 to over 1,000 in 2002.[419] During the period from 1994 to late 2003,

---

[415] Rev. Rul. 69-441, 1969-2 C.B. 115.

[416] Debt management plans are debt payment arrangements, including debt consolidation arrangements, entered into by a debtor and one or more of the debtor's creditors, generally structured to reduce the amount of a debtor's regular ongoing payment by modifying the interest rate, minimum payment, maturity or other terms of the debt. Such plans frequently are promoted as a means for a debtor to restructure debt without filing for bankruptcy.

[417] *Consumer Credit Counseling Service of Alabama, Inc. v. U.S.*, 44 A.F.T.R. 2d (RIA) 5122 (D.D.C. 1978). The case involved 24 agencies throughout the United States.

[418] *See also*, *Credit Counseling Centers of Oklahoma, Inc., v. U.S.*, 45 A.F.T.R. 2d (RIA) 1401 (D.D.C. 1979) (holding the same on virtually identical facts).

[419] Opening Statement of The Honorable Max Sandlin, Hearing on Non-Profit Credit Counseling Organizations, House Ways and Means Committee, Subcommittee on Oversight (November 20, 2003).

1,215 credit counseling organizations applied to the IRS for tax exempt status under section 501(c)(3), including 810 during 2000 to 2003.[420] The IRS has recognized more than 850 credit counseling organizations as tax exempt under section 501c)((3).[421] Few credit counseling organizations have sought section 501(c)(4) status, and the IRS reports it has not seen any significant increase in the number or activity of such organizations operating as social welfare organizations.[422] As of late 2003, there were 872 active tax-exempt credit counseling agencies operating in the United States.[423]

A credit counseling organization described in section 501(c)(3) is exempt from certain Federal and State consumer protection laws that provide exemptions for organizations described therein.[424] Some believe that these exclusions from Federal and State regulation may be a primary motivation for the recent increase in the number of organizations seeking and obtaining exempt status under section 501(c)(3).[425] Such regulatory exemptions generally are not available for social welfare organizations described in section 501(c)(4).

---

[420] United States Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling*, Report Prepared by the Majority & Minority Staffs of the Permanent Subcommittee on Investigations and Released in Conjunction with the Permanent Subcommittee Investigations' Hearing on March 24, 2004, p. 3 (citing letter dated December 18, 2003, to the Subcommittee from IRS Commissioner Everson).

[421] Testimony of Commissioner Mark Everson before the House Ways and Means Committee, Subcommittee on Oversight (November 20, 2003).

[422] Testimony of Commissioner Mark Everson before the House Ways and Means Committee, Subcommittee on Oversight (November 20, 2003).

[423] United States Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling*, Report Prepared by the Majority & Minority Staffs of the Permanent Subcommittee on Investigations and Released in Conjunction with the Permanent Subcommittee Investigations' Hearing on March 24, 2004, p. 3 (citing letter dated December 18, 2003 to the Subcommittee from IRS Commissioner Everson).

[424] *E.g.*, The Credit Repair Organizations Act, 15 U.S.C. section 1679 *et seq*., effective April 1, 1997 (imposing restrictions on credit repair organizations that are enforced by the Federal Trade Commission, including forbidding the making of untrue or misleading statements and forbidding advance payments; section 501(c)(3) organizations are explicitly exempt from such regulation). Testimony of Commissioner Mark Everson before the House Ways and Means Committee, Subcommittee on Oversight (November 20, 2003) (California's consumer protections laws that impose strict standards on credit service organizations and the credit repair industry do not apply to nonprofit organizations that have received a final determination from the IRS that they are exempt from tax under section 501(c)(3) and are not private foundations).

[425] Testimony of Commissioner Mark Everson before the House Ways and Means Committee, Subcommittee on Oversight (November 20, 2003).

Congress recently conducted hearings investigating the activities of credit counseling organizations under various consumer protection laws,[426] such as the Federal Trade Commission Act.[427] In addition, the IRS commenced a broad examination and compliance program with respect to the credit counseling industry. On May 15, 2006, the IRS announced that over the past two years, it had been auditing 63 credit counseling agencies, representing more than 40 percent of the revenue in the industry. Audits of 41 organizations, representing more than 40 percent of the revenue in the industry have been completed as of that date. All of such completed audits resulted in revocation, proposed revocation, or other termination of tax-exempt status.[428] In addition, the IRS released two legal documents that provide a legal framework for determining the exempt status and related issues with respect to credit counseling organizations.[429] In CCA 200620001, the IRS found that "[t]he 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." The CCA concluded that whether a credit counseling organization primarily furthers educational purposes

> can be determined by assessing the methodology by which the organization conducts its counseling activities. The process an 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 individual's best interest.

Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Public Law 109-8, an individual generally may not be a debtor in bankruptcy unless such individual has, within 180 days of filing a petition for bankruptcy, received from an approved nonprofit budget and credit counseling agency an individual or group briefing that outlines the opportunities for available credit counseling and assists the individual in performing a related

---

[426] United States Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling*, Report Prepared by the Majority & Minority Staffs of the Permanent Subcommittee on Investigations and Released in Conjunction with the Permanent Subcommittee Investigations' Hearing on March 24, 2004.

[427] 15 U.S.C. sec. 45(a) (prohibiting unfair and deceptive acts or practices in or affecting commerce; although the Federal Trade Commission generally lacks jurisdiction to enforce consumer protection laws against bona fide nonprofit organizations, it may assert jurisdiction over a nonprofit, including a credit counseling organization, if it demonstrates the organization is organized to carry on business for profit, is a mere instrumentality of a for-profit entity, or operates through a common enterprise with one or more for-profit entities).

[428] IRS News Release, IR-2006-80, May 15, 2006.

[429] Chief Counsel Advice 200431023 (July 13, 2004); Chief Counsel Advice 200620001 (May 9, 2006).

budget analysis.[430] The clerk of the court must maintain a publicly available list of nonprofit budget and credit counseling agencies approved by the U.S. Trustee (or bankruptcy administrator). In general, the U.S. Trustee (or bankruptcy administrator) shall only approve an agency that demonstrates that it will provide qualified counselors, maintain adequate provision for safekeeping and payment of client funds, provide adequate counseling with respect to client credit problems, and deal responsibly and effectively with other matters relating to the quality, effectiveness, and financial security of the services it provides. The minimum qualifications for approval of such an agency include: (1) in general, having an independent board of directors; (2) charging no more than a reasonable fee, and providing services without regard to ability to pay; (3) adequate provision for safekeeping and payment of client funds; (4) provision of full disclosures to clients; (5) provision of adequate counseling with respect to a client's credit problems; (6) trained counselors who receive no commissions or bonuses based on the outcome of the counseling services; (7) experience and background in providing credit counseling; and (8) adequate financial resources to provide continuing support services for budgeting plans over the life of any repayment plan. An individual debtor must file with the court a certificate from the approved nonprofit budget and credit counseling agency that provided the required services describing the services provided, and a copy of the debt management plan, if any, developed through the agency.[431]

Explanation of Provision

Requirements for exempt status of credit counseling organizations

The provision establishes standards that a credit counseling organization must satisfy, in addition to present law requirements, in order to be organized and operated either as an organization described in section 501(c)(3) or in section 501(c)(4). The provision does not diminish the requirements set forth recently by the IRS in Chief Counsel Advice 200431023 or Chief Counsel Advice 200620001 but builds on and is consistent with such requirements, and the analysis therein. The provision is not intended to raise any question about IRS actions taken, and the IRS is expected to continue its vigorous examination of the credit counseling industry, applying the additional standards provided by the provision. The provision does not and is not intended to affect the approval process for credit counseling agencies under Public Law 109-8. Public Law 109-8 requires that an approved credit counseling agency be a nonprofit, and does not require that an approved agency be a section 501(c)(3) organization. It is expected that the

[430] This requirement does not apply in certain circumstances, such as: (1) in general, where a debtor resides in a district for which the U.S. Trustee has determined that the approved counseling agencies for such district are not reasonably able to provide adequate services to additional individuals; (2) where exigent circumstances merit a waiver, the individual seeking bankruptcy protection files an appropriate certification with the court, and the certification is acceptable to the court; and (3) in general, where a court determines, after notice and hearing, that the individual is unable to complete the requirement because of incapacity, disability, or active military duty in a military combat zone.

[431] The Act also requires that, prior to discharge of indebtedness under chapter 7 or chapter 13, a debtor complete an approved instructional course concerning personal financial management, which course need not be conducted by a nonprofit agency.

Department of Justice shall continue to approve agencies for purposes of providing pre-bankruptcy counseling based on criteria that are consistent with such Public Law.

Under the provision, an organization that provides credit counseling services as a substantial purpose of the organization ("credit counseling organization") is eligible for exemption from Federal income tax only as a charitable or educational organization under section 501(c)(3) or as a social welfare organization under section 501(c)(4), and only if (in addition to present-law requirements) the credit counseling organization is organized and operated in accordance with the following:

1. The organization provides credit counseling services tailored to the specific needs and circumstances of the consumer;

2. The organization 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;[432]

3. The organization provides services for the purpose of improving a consumer's credit record, credit history, or credit rating only to the extent that such services are incidental to providing credit counseling services and does not charge any separately stated fee for any such services;[433]

4. The organization does not refuse to provide credit counseling services to a consumer due to inability of the consumer to pay, the ineligibility of the consumer for debt management plan enrollment, or the unwillingness of a consumer to enroll in a debt management plan;

5. The organization establishes and implements a fee policy to require that any fees charged to a consumer for its services are reasonable,[434] allows for the waiver of fees if the consumer is unable to pay, and except to the extent allowed by State law prohibits charging any fee based in whole or in part on a percentage of the consumer's debt, the consumer's payments to be made pursuant to a debt management plan, or on the projected or actual savings to the consumer resulting from enrolling in a debt management plan;

---

[432] In general, negotiation of a loan involves negotiation of the terms of a loan, rather than the processing of a loan. 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.

[433] Accordingly, a credit counseling organization may provide credit repair type services, but only to the extent that the provision of such services is a direct outgrowth of the provision of credit counseling services.

[434] Whether a credit counseling organization's fees are consistent with specific State law requirements is evidence of the reasonableness of fees but is not determinative.

6. The organization at all times has a board of directors or other governing body (a) that is controlled by persons who represent the broad interests of the public, such as public officials acting in their capacities as such, persons having special knowledge or expertise in credit or financial education, and community leaders; (b) not more than 20 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the repayment of consumer debt to creditors other than the credit counseling organization or its affiliates) and (c) not more than 49 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees);[435]

7. The organization does not own (except with respect to a section 501(c)(3) organization) more than 35 percent of the total combined voting power of a corporation (or profits or beneficial interest in the case of a partnership or trust or estate) that is in the trade or business of lending money, repairing credit, or providing debt management plan services, payment processing, and similar services; and

8. The organization receives no amount for providing referrals to others for debt management plan services, and pays no amount to others for obtaining referrals of consumers.[436]

Additional requirements for charitable and educational organizations

Under the provision, a credit counseling organization is described in section 501(c)(3) only if, in addition to satisfying the above requirements and the requirements of section 501(c)(3), the organization is organized and operated such that the organization (1) does not solicit contributions from consumers during the initial counseling process or while the consumer is receiving services from the organization and (2) the aggregate revenues of the organization that are from payments of creditors of consumers of the organization and that are attributable to debt management plan services do not exceed the applicable percentage of the total revenues of the organization. For credit counseling organizations in existence on the date of enactment, the

[435] The requirements described in paragraphs 4, 5, and 6 above address core issues that are related to tax-exempt status and that have proved to be problematic in the credit counseling industry--the provision of services and waiver of fees without regard to ability to pay, the establishment of a reasonable fee policy, and the presence of independent board members. No inference is intended through the provision of these specific requirements on credit counseling organizations that similar or more stringent requirements should not be adhered to by other exempt organizations providing fees for services. Rather, the provision affirms the importance of these core issues to the matter of tax exemption, both to credit counseling organizations and to other types of exempt organizations.

[436] If a credit counseling organization pays or receives a fee, for example, for using or maintaining a locator service for consumers to find a credit counseling organization, such a fee is not considered a referral.

applicable percentage is 80 percent for the first taxable year of the organization beginning after the date which is one year after the date of enactment, 70 percent for the second such taxable year beginning after such date, 60 percent for the third such taxable year beginning after such date, and 50 percent thereafter. For new credit counseling organizations, the applicable percentage is 50 percent for taxable years beginning after the date of enactment. Satisfaction of the aggregate revenues requirement is not a safe harbor; all other requirements of the provision (and of section 501(c)(3)) pertaining to section 501(c)(3) organizations also must be satisfied. Satisfaction of the aggregate revenues requirement means only that an organization has not automatically failed to be organized or operated consistent with exempt purposes. Compliance with the revenues test does not mean that the organization's debt management plan services activity is at a level that organizationally or operationally is consistent with exempt status. In other words, satisfaction of the aggregate revenues requirement (as a preliminary matter in an exemption application, or on an ongoing operational basis) provides no affirmative evidence that an organization's primary purpose is an exempt purpose, or that the revenues that are subject to the limitation (or debt management plan services revenues more generally) are related to exempt purposes. As described below, whether revenues from such activity are substantially related to exempt purposes depends on the facts and circumstances, that is, satisfaction of the aggregate revenues requirement generally is not relevant for purposes of whether any of an organization's revenues are revenues from an unrelated trade or business. Failure to satisfy the aggregate revenues requirement does not disqualify the organization from recognition of exemption under section 501(c)(4).

Additional requirement for social welfare organizations

Under the provision, a credit counseling organization is described in section 501(c)(4) only if, in addition to satisfying the above requirements applicable to such organizations, the organization notifies the Secretary, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition as a credit counseling organization.

Debt management plan services treated as an unrelated trade or business

Under the provision, debt management plan services are treated as an unrelated trade or business for purposes of the tax on income from an unrelated trade or business to the extent such services are provided by an organization that is not a credit counseling organization. With respect to the provision of debt management plan services by a credit counseling organization, in order for the income from such services not to be unrelated business income, it is intended that, consistent with current law, the debt management plan service with respect to such income (1) must contribute importantly to the accomplishment of credit counseling services, and (2) must not be conducted on a larger scale than reasonably is necessary for the accomplishment of such services. For example, the provision of debt management plan services would not be substantially related to accomplishing exempt purposes if the organization recommended and enrolled an individual in a debt management plan only after determining whether the individual satisfied the financial criteria established by the creditors for such plan, without (1) considering whether it was an appropriate action in light of the individual's particular needs and objectives, (2) discussing the disadvantages of a debt management plan with the consumer, and (3) presenting other possible options to such consumer.

Definitions

Credit counseling services

Credit counseling services are (a) 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; (b) the assisting of individuals and families with financial problems by providing them with counseling; or (c) any combination of such activities.

Debt management plan services

Debt management plan services are 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.

Effective Date

In general, the provision applies to taxable years beginning after the date of enactment. For a credit counseling organization that is described in section 501(c)(3) or 501(c)(4) on the date of enactment, the provision is effective for taxable years beginning after the date that is one year after the date of enactment.

11. Expand the base of the tax on private foundation net investment income (sec. 4940 of the Code)

Present Law

In general

Under section 4940(a) of the Code, private foundations that are recognized as exempt from Federal income tax under section 501(a) of the Code are subject to a two-percent excise tax on their net investment income. Private foundations that are not exempt from tax, such as certain charitable trusts,[437] also are subject to an excise tax under section 4940(b) based on net investment income and unrelated business income. The two-percent rate of tax is reduced to one-percent if certain requirements are met in a taxable year.[438] Unlike certain other excise taxes imposed on private foundations, the tax based on investment income does not result from a violation of substantive law by the private foundation; it is solely an excise tax.

The tax on taxable private foundations under section 4940(b) is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if

[437] *See* sec. 4947(a)(1).

[438] Sec. 4940(e).