



*Abuses in the Tax-Exempt Credit
Counseling Industry Are Being Addressed,
but Further Actions Are Needed to Ensure
Overall Industry Compliance*

May 2006

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 22, 2006

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

Michael R. Phillips
FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Abuses in the Tax-Exempt Credit Counseling
Industry Are Being Addressed, but Further Actions Are Needed to
Ensure Overall Industry Compliance (Audit # 200510020)

This report presents the results of our review of the Exempt Organizations (EO) function's efforts to oversee the tax-exempt credit counseling industry. The overall objective of this review was to assess the EO function's efforts to address abusive activities by tax-exempt credit counseling organizations.

Synopsis

The EO function of the Tax Exempt and Government Entities Division has responsibility for ensuring charitable or other tax-exempt organizations are in compliance with the Internal Revenue Code (I.R.C.). The EO function has two primary programs for ensuring compliance, the Determinations Program (reviewing requests from organizations seeking tax-exempt status) and the Examinations Program (reviewing information about existing organizations).

To qualify as a tax-exempt credit counseling organization under I.R.C. § 501(c)(3),¹ the organization must limit its services to low-income customers or, as its primary activity, provide education to the public on how to manage personal finances. However, according to the Commissioner of Internal Revenue, the focus of the credit counseling industry has shifted over the past several years from providing education or charitable service to inappropriately enrolling debtors in proprietary debt management plans² and credit-repair schemes for a fee. These

¹ I.R.C. § 501(c)(3) (2005).

² 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



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activities may be disadvantageous to the debtors and are not consistent with the requirements for tax exemption. Congress and the Commissioner of Internal Revenue have expressed their concern that many credit counseling organizations are in violation of I.R.C. § 501(c)(3) requirements.

The IRS has begun to address abuses by tax-exempt credit counseling organizations, including revoking tax-exempt status for some organizations. However, the accuracy of the IRS' inventory system should be improved to ensure future efforts can adequately cover this industry.

Starting in Fiscal Year 2003, EO function management took actions to begin to address abuses by tax-exempt credit counseling organizations. Specifically, the EO function created a multifaceted strategy to combat abuses in the industry and designated a team of EO function personnel to oversee the strategic management of its compliance efforts. Also, EO function management added a specialized review of the applications for tax-exempt status from credit counseling organizations. In addition, the EO function Examinations office initiated a broad examination effort of high-risk tax-exempt credit counseling organizations. Further, the Internal Revenue Service (IRS) has partnered with the Federal Trade Commission, the National

Association of State Charity Officials, and other industry trade associations to address industry concerns and establish an ongoing dialogue with outside stakeholders. Finally, at the end of our fieldwork, the EO function provided us with a working draft of a strategic plan which establishes current and future plans to address abuses in the tax-exempt credit counseling industry.

However, based on our review of the draft strategic plan and discussions with EO function personnel, we believe the plan should contain more specific guidelines to improve the accuracy of the IRS' inventory system related to credit counseling organizations. An accurate inventory system of the population of tax-exempt credit counseling organizations will enable the IRS to ensure its efforts can adequately cover this industry. Specifically, 162 (21 percent) of the 788 organizations contained on the EO function inventory of credit counseling organizations may not have the proper identification code for tax-exempt credit counseling organizations. In addition, an initial IRS analysis conducted in 2004 determined that 96 organizations included in a preliminary universe of credit counseling organizations may be inaccurate. However, 89 of these organizations were still included on the EO function's current inventory of 788 credit counseling organizations at the end of our fieldwork. Further, a February 2005 administrative decision to change the coding used to close certain types of credit counseling applications resulted in inconsistent credit counseling data on the IRS' inventory system.

As part of the Credit Counseling Compliance Project, EO function management has developed some guidelines on how to process requests for tax-exempt status from credit counseling organizations. However, these guidelines were generally informal in nature, and some were

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.



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shared with applicable EO function personnel either verbally or via email. In addition, the EO function was not ensuring all advance ruling cases related to credit counseling organizations were always reviewed by the specialized Determinations office group to identify any potential abuses, as required by EO function procedures.

Recommendations

We recommended the Director, EO, take the necessary actions to ensure the EO function inventory system contains accurate information related to tax-exempt credit counseling organizations and finalize and implement the draft strategic plan for addressing current and future credit counseling activities. We also recommended the Director, EO, update and formalize application processing procedures and related training guides to ensure the consistent processing of applications for tax-exempt status by credit counseling organizations.

Response

EO function management agreed with our three recommendations. EO function management will review codes for the credit counseling population to ensure they are accurate and develop procedures to review incoming referrals to ensure they are accurately coded. In addition, EO function management issued a directive discontinuing the use of a specific activity code and will update its inventory records to ensure an accurate and complete population.

EO function management is also finalizing and implementing a strategy to address credit counseling abuses in the future to ensure compliance in the industry and that any new organizations are appropriately reviewed. EO function management will incorporate training guidelines on reviewing credit counseling applications and updated Internet training into a formal training package. Finally, EO function management issued a directive to reemphasize the use of procedures for processing specific types of credit counseling cases. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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Background

The practice known as “credit counseling” was initiated during the mid-1960s in an effort to stem the growing volume of personal bankruptcies. Initially, credit counseling organizations were community-based, nonprofit organizations that provided a full range of counseling, often in face-to-face meetings. Trained counselors would advise consumers on how to remedy their current financial problems, counsel them on budget planning, and educate them on how to avoid falling into debt in the future. To qualify as a tax-exempt credit counseling organization under Internal Revenue Code (I.R.C.) Section (§) 501(c)(3),¹ the organization must limit its services to low-income customers or, as its primary activity, provide education to the public on how to manage personal finances. However, according to the Commissioner of Internal Revenue, the focus of the credit counseling industry has shifted over the past several years from providing education or charitable service to inappropriately enrolling debtors in proprietary debt management plans² and credit-repair schemes for a fee. These activities may be disadvantageous to the debtors and are not consistent with the requirements for tax exemption.

Another factor in the growing concern about abuses in this industry is that I.R.C. § 501(c)(3) organizations are often excluded from coverage under Federal Trade Commission (FTC) rules, as well as State and local consumer protection laws. This combination of exemption from income tax and exemption from consumer protection laws may be one of the primary reasons for the increase in the number of credit counseling organizations seeking tax-exempt status since Fiscal Year (FY) 2000. Congress and the Commissioner of Internal Revenue have expressed their concern that many of these credit counseling organizations are in violation of I.R.C. § 501(c)(3) requirements.

The Exempt Organizations (EO) function of the Tax Exempt and Government Entities Division has responsibility for ensuring charitable or other tax-exempt organizations are in compliance with the I.R.C. The EO function has two primary programs for ensuring compliance, the Determinations Program (reviewing requests from organizations seeking tax-exempt status) and the Examinations Program (reviewing information about existing organizations). In general, an organization that wants to be recognized as tax exempt under I.R.C § 501(c)(3) must apply to the Internal Revenue Service (IRS) for a determination of its status by completing an Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (Form 1023). If the organization’s application and supporting documents establish that it meets the particular

¹ I.R.C. § 501(c)(3) (2005).

² 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; they are 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.



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requirements of I.R.C. § 501(c)(3), the EO function will issue a determination letter to the organization to affirm the organization is exempt under I.R.C. § 501(c)(3). In addition, the EO function Examinations office has responsibility for identifying and reviewing allegations of potential noncompliance with the I.R.C. by tax-exempt organizations.

An April 2003 report³ from the Consumer Federation of America and the National Consumer Law Center estimates nearly 9 million people in financial trouble contact credit counseling organizations annually. According to IRS records, 1,081 potential credit counseling organizations initially applied to the IRS for tax-exempt status between October 1, 2003, and October 18, 2005. As of November 2005, IRS inventory records listed 788 approved tax-exempt credit counseling organizations. Revenue reported for Tax Year 2000 for this tax-exempt industry was approximately \$1 billion.

This review was performed at the Tax Exempt and Government Entities Division Headquarters in Washington, D.C.; the Cincinnati, Ohio, Area Office; and the EO Examinations office field office in Mountainside, New Jersey, during the period May through October 2005. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

³ *Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees, and Aggressive New Market Entrants.*



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Results of Review

The Exempt Organizations Function Has Taken Numerous Actions to Begin to Address Abuses in the Tax-Exempt Credit Counseling Industry

As a result of concerns raised by internal and external stakeholders that many credit counseling organizations were abusing their tax-exempt status, the EO function designated this issue as one of its highest priorities in FY 2004 and initiated a Credit Counseling Compliance Project. Based on our discussions with EO function management and review of applicable documentation, we determined that, starting in FY 2003, EO function management took actions to begin to address abuses by tax-exempt credit counseling organizations. Specifically, the EO function created a multifaceted strategy to combat abuses in the industry and designated a team of EO function personnel to oversee the strategic management of its compliance efforts. In FY 2004, EO function management added a specialized review of the applications for tax-exempt status from credit counseling organizations. In addition, the EO function Examinations office initiated a broad examination effort of high-risk tax-exempt credit counseling organizations. Further, the IRS has partnered with the FTC, the National Association of State Charity Officials, and other industry trade associations to address industry concerns and establish an ongoing dialogue with outside stakeholders. Finally, at the end of our fieldwork, the EO function provided us with a working draft of a strategic document which establishes its plans to address abuses in the tax-exempt credit counseling industry, covering both ongoing work and additional areas needing coverage in the future.

The EO function has improved its process for reviewing applications for tax-exempt status by credit counseling organizations

In October 2003, the EO function initiated changes to its application process to ensure increased scrutiny of organizations requesting tax-exempt status for credit counseling activities. Specifically, EO function management required that EO function personnel at the Cincinnati Determinations office identify all applications for tax-exempt status received from credit counseling organizations, assign a unique tracking code on its inventory system for these applications, and forward the applications to a new, specialized group for detailed review. This specialized group, trained in credit counseling issues, was responsible for reviewing all applications from credit counseling organizations to determine whether tax-exempt status should be approved. This group conducts a determination review that includes Internet research to determine if the proposed activities of the organization are in line with the application. If additional information is required, the specialized group sends the organization an inquiry letter



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to more fully develop the facts and circumstances of the case. This inquiry letter was specifically updated for credit counseling activities and has been further refined since the initiation of the Credit Counseling Compliance Project to provide additional data to help in the determination process. If no evidence of potential abuse exists, this group will approve the organization's request for tax-exempt status and issue a positive determination letter to the organization.

If evidence of potential abuse exists, additional analysis will be performed to determine if tax-exempt status should be denied. Prior to October 2003, EO function Determinations office specialists could deny any requests for tax-exempt status based on the facts contained in the application and issue a denial letter to the organization without further review. However, starting in October 2003, as part of the Credit Counseling Compliance Project, EO function management revised the denial process for credit counseling organizations to ensure consistency in determining the denial. Specifically, if the specialized group identified potential abusive activity, the credit counseling application request was sent to the EO Technical office in Washington, D.C., for further scrutiny. The EO Technical office consists of senior EO function management with significant experience in exempt organizations law who were trained in credit counseling issues. The EO Technical office is responsible for providing technical advice and assistance on exempt organizations issues by responding to specific requests from EO function personnel and other Government organizations. If the EO Technical office determines the organization does not meet the requirements under I.R.C. § 501(c)(3), a letter is sent to the organization proposing denial of the application. As of September 30, 2005, the EO Technical office had reviewed 119 potentially abusive applications. Of these:

- Eighteen were denied.
- Ten were proposed for denial (pending administrative action).
- Seven were withdrawn by the organization.
- Forty-four were closed due to insufficient information.⁴
- Two were approved and given tax-exempt status.
- Seven were reclassified as nonabusive and returned to the specialized group for review.
- Thirty-one were still being reviewed.

At the end of our fieldwork, EO function management was proposing these applications would no longer be required to be sent to the EO Technical office. Instead, EO function management was proposing all requests for tax-exempt status by credit counseling organizations be worked to resolution, including denial if appropriate, by the specialized group in Cincinnati, Ohio, because

⁴ The EO Determinations office and EO Technical office designate a case "Failure to Establish" when an applicant fails to timely respond to a request for additional information the IRS needs to process the application. As a result, EO function personnel did not have enough information to fully process the application to approve or deny tax-exempt status.



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they believed EO Determinations office personnel now had the skills and resources necessary to work these cases to resolution. After our fieldwork ended, EO Technical office management advised us that, beginning in mid-January 2006 for a 6-month period, they plan to coordinate with the EO function Quality Assurance group to perform a mandatory review of the cases closed by the specialized group. At the end of this period, the process will be evaluated to determine if the EO Technical office will need to continue to perform mandatory review of these cases.

The EO function has initiated a broad examination effort of potentially abusive credit counseling organizations

The EO function has initiated a broad examination effort of the credit counseling industry. Due to complex issues involving credit counseling organizations and the need to examine related for-profit entities,⁵ if they are used, the Credit Counseling Compliance Project is being worked by combining EO function personnel with compliance personnel from the IRS Small Business/Self-Employed and Large and Mid-Size Business Divisions, as well as staff from the Office of Chief Counsel.

Based on our interviews and review of applicable documentation, the EO function has identified 62⁶ tax-exempt credit counseling organizations for examination to determine if these organizations are operating within the scope of their tax-exempt status. According to the EO function, the 62 credit counseling organizations represent approximately 61 percent of the total estimated revenues⁷ of the tax-exempt credit counseling organizations that have filed required annual information returns. As shown in Figure 1, a significant level of noncompliance had been identified as of September 30, 2005. For example, none of the examinations completed by the end of our fieldwork had determined the organizations were operating in accordance with their exempt purpose. In addition, 35 examinations had resulted in the tax-exempt status being revoked, the revocation was pending, or the organization had been referred for consideration by the Criminal Investigation function. This unusually high noncompliance rate may have resulted because the majority of these examinations were initiated after referrals from external sources, such as Attorneys General of various States, the FTC, media leads, and other third parties. EO function management's goal is to complete 60 of the examinations by December 31, 2006. Examination completion dates for two newly assigned cases were unknown as of January 2006.

⁵ For-profit entities related to credit counseling organizations include entities that are involved in the administrative processing of debt management plans.

⁶ Initially, the EO function identified 60 tax-exempt credit counseling organizations for examination. Subsequently, two additional credit counseling organizations were identified for examination in August 2005.

⁷ Based on Tax Year 2000 filing data.



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Figure 1: Status of IRS Examinations of 62 Credit Counseling Organizations As of September 30, 2005

Status of the 62 Credit Counseling Organizations Selected for Examination	Number of Cases	Estimated Annual Revenues ⁸ for the Organizations Being Examined, by Status of Examination	Percentage of the Estimated Annual Revenues ⁹ Compared to the Entire Tax-Exempt Credit Counseling Industry (\$990,281,021 Annually)
Case Assigned but Not Started	9	\$59,265,379	6%
Examination Ongoing	18	\$151,608,832	15%
Closed – Tax-Exempt Status Revoked	6	\$4,097,044	.4%
Examination Completed – Revocation of Tax-Exempt Status Proposed	21	\$354,446,191	36%
Referred to the Criminal Investigation Function for Potential Fraud	8	\$36,717,417	4%
Total Inventory:	62	\$606,134,863	61%

Source: EO function Examinations office status reports.

The IRS has coordinated with outside stakeholders to increase awareness of potentially abusive tax-exempt credit counseling activities

During the past several years, the IRS has provided outreach efforts related to questionable activities performed by credit counseling organizations. The IRS has also acted to establish an ongoing dialogue with other organizations to coordinate enforcement actions and share limited information. These outreach efforts have helped to educate the public about the IRS’ efforts to increase compliance in the credit counseling industry, as well as inform tax-exempt credit counseling organizations of the standards that must be met to maintain tax-exempt status. Specifically, the IRS has:

- Partnered with the FTC and Attorneys General from various States to issue a consumer alert in October 2003 through a news release and fact sheet to warn consumers some credit counseling organizations are engaging in questionable activities. The news release warns the public of high fees or required “voluntary contributions” that, with high monthly service charges, may add to their debt and defeat their efforts to pay bills.

⁸ Based on Tax Year 2000 filing data.

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- Conducted presentations at various credit counseling trade association conferences to inform participants about the IRS' credit counseling initiative and to open a dialog with participants.
- Conducted presentations in 2003 and 2005 to the American Bar Association and discussed potential problems relating to the credit counseling industry.
- Prepared a Continuing Professional Education article on credit counseling organizations for EO function personnel and posted the article on the Tax Exempt and Government Entities Division public web site on January 13, 2003, to raise awareness of potential abuses by credit counseling organizations and discuss the qualifications for credit counseling organizations under I.R.C. § 501(c)(3).
- Developed an informational training video in conjunction with the Attorneys General from various States and the FTC that discussed potential abuses within the credit counseling industry. This video was broadcast within the IRS on March 5, 2003, and April 22, 2003, shared with the States, and sent to Congressional staff.
- Initiated meetings in FY 2004 with the United States Bankruptcy Trustees office to discuss the impact of the Bankruptcy Abuse and Consumer Protection Act of 2005¹⁰ (signed into law on April 20, 2005) on tax-exempt credit counseling organizations.
- Held discussions with three trade associations in August 2005 to obtain concerns related to the credit counseling industry.
- Sponsored practitioner telephone forums on changes made to the application for tax exemption and IRS observations on the new applications received (e.g., what types of information are typically missing or omitted from the applications).

IRS management has revised tax forms and prepared plans to help address credit counseling abuses in the future

The IRS has revised two key forms which should help the effort to address abuses in tax-exempt organizations, including credit counseling organizations. In October 2004, the IRS issued a revised Form 1023, which is used for all types of organizations seeking tax exemption under I.R.C. § 501(c)(3). The revised Form added questions focusing on the relationship between the applicant and any management or servicing entities with which it does business. The additional information will be used to assist EO function personnel to more easily evaluate the credit counseling organization's application by disclosing the relationships the applicant has with for-profit entities.

¹⁰ Pub. L. No. 109-8, 109 Stat. 23 (2005).



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The IRS also revised the Return of Organization Exempt From Income Tax (Form 990) in 2004 to specifically require tax-exempt organizations to disclose whether they provide credit counseling, debt management, credit repair, or debt negotiation services. This information will help identify organizations that have added credit counseling activities after having established tax-exempt status as a different kind of charitable organization. This revised annual information return was effective for all Forms 990 filed for Tax Year 2004. A planned revision to the 2005 Form 990 includes a further request that tax-exempt organizations list the top five highest paid independent contractors for other than professional services.¹¹ This additional information may also help to identify possible abuses in the credit counseling industry, including relationships between board members or executives and independent contractors who are being paid for substantial work.

Further, EO function management has prepared a draft strategy detailing future plans to address the problems in the tax-exempt credit counseling industry. This strategy was developed to expedite the examination of cases open at the time the strategy document is finalized, streamline the approach for future Determinations and Examinations office reviews of credit counseling organizations, and ensure consistency on all credit counseling cases worked by the EO function. This strategy includes the development of additional analytical tools that will be used by Examinations and Determinations office personnel to evaluate key issues common to tax-exempt credit counseling organizations to determine if the organizations are operating within I.R.C. § 501(c)(3) guidelines and to take any necessary steps to ensure compliance. The draft strategy was initially scheduled to be prepared by March 1, 2005. However, this strategy was still in draft status and not yet approved as of October 2005. EO function management attributed the delay in obtaining final approval to the complexity of the issues involved.

Based on our review of documentation outlining the draft strategy, EO function management has identified several areas that need to be addressed to more effectively and efficiently review and analyze tax-exempt credit counseling organizations (by both Determinations and Examinations office personnel) to ensure compliance within this industry. These actions, some of which had been developed but not yet fully implemented by the end of our fieldwork, include:

- Enhancing guidance that can be used by EO function Determinations and Examinations office personnel to identify the minimum standards that must be met for new organizations to be granted tax-exempt status for credit counseling activities, as well as attributes that should be developed to support a decision to revoke/deny tax-exempt status.
- Implementing revised classification criteria to better assist in the identification of potentially noncompliant credit counseling organizations for examination. The revised criteria will be modified based on information learned during the Credit

¹¹ Professional services include accountants, lawyers, auditors, professional fundraisers, etc.



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Counseling Compliance Project on the common indicators of abusive activities. Although some of the examinations in the Compliance Project were the result of internal IRS referrals, the majority of the 62 examinations were based on external referrals. Based on the revised criteria, the EO function anticipates it will also be able to identify high-risk noncompliant organizations through internal reviews.

- Implementing a separate process for identifying and examining organizations that have not filed a current information return.
- Following up on organizations that have had tax-exempt status revoked to ensure they are no longer in business. This will be a future effort, as the first revocations are being processed through the current Compliance Project.
- Performing additional work on organizations whose requests for tax-exempt status were denied or not established during the application process, to ensure these organizations are not continuing to operate and falsely informing the public they are tax exempt.
- Establishing a periodic review schedule of organizations that have agreed to discontinue their abusive activities so they can continue to maintain their tax-exempt status.
- Correcting its database of tax-exempt credit counseling organizations by contacting small organizations not required to file Form 990 (organizations with gross receipts that do not exceed \$25,000) and other credit counseling organizations not under examination to determine if they are currently providing credit counseling services.

Further Actions Should Be Taken to Enable the Exempt Organizations Function to Address Abuses Across the Tax-Exempt Credit Counseling Industry

As stated previously, EO function management has taken numerous actions to begin to address abuses by tax-exempt credit counseling organizations. According to EO function management, these actions have served to halt the proliferation of new abusive credit counseling organizations and to revoke the exemption of existing abusive credit counseling organizations. However, based on the high level of noncompliance identified to date by the EO function and the potential for a continued increase in credit counseling organizations seeking tax-exempt status, we believe there is significant continued risk for abuses in this area. EO function management has recognized that additional actions are needed to address the rest of the industry, and the EO function is continuing to emphasize its efforts in the tax-exempt credit counseling industry. This is reflected in its draft strategic plan.



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However, based on our review of the draft strategic plan and discussions with EO function personnel, we believe the plan should contain more specific guidelines to improve the accuracy of the IRS' inventory system related to credit counseling organizations. We identified inaccuracies on the inventory system, which we discussed with EO function management during our fieldwork. Although the draft strategic plan contains general guidelines to improve the accuracy of information for credit counseling organizations on the IRS' inventory system, we do not believe these guidelines are specific enough to ensure the inventory system will be accurate. An accurate inventory system of the population of tax-exempt credit counseling organizations will enable the IRS to ensure its efforts can adequately cover this industry. This assurance, however, will not be attained until the strategic plan is finalized and implemented and actions are taken to correct the inaccuracies in the inventory system. In addition, we identified the need to update and formalize procedures to ensure credit counseling cases are processed consistently.

The EO function's inventory system does not contain accurate information related to the population of credit counseling organizations

Based on our review of available documentation, we determined the EO function does not have accurate information on its inventory system to identify all credit counseling organizations. EO function management also expressed concerns with the accuracy of this information. For example:

- In FY 2004, EO function staff identified organizations on its inventory system that may not be credit counseling organizations; however, these organizations were still coded as credit counseling organizations at the end of our fieldwork. We believe these organizations should be reviewed to determine whether they are accurately coded on the inventory system.
- In addition, some organizations referred to the EO Referral and Claims Classification Unit as participating in potentially abusive credit counseling activities were not included in the EO function's population of credit counseling organizations as of October 2005.

If organizations are not properly coded on the IRS' inventory system, there is a risk that potentially abusive credit counseling organizations may not be identified by EO function personnel for future compliance activity. With the high risk of abuse in the industry, this may allow abuses to continue undetected, resulting in the loss of potential tax revenues. In addition, inaccurate information related to these organizations may result in inefficient use of limited EO function resources and increased taxpayer burden if organizations improperly coded as credit counseling organizations are selected for examination and it is determined they are in compliance with the laws.



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Since approximately 1995, the IRS has used the National Taxonomy of Exempt Entities (NTEE)¹² coding system to classify organizations that have been approved for tax-exempt status. Special care is needed in selecting the appropriate NTEE code for each organization because it is relied on as a source of data by a variety of organizations, including the IRS Statistics of Income Division,¹³ the Urban Institute,¹⁴ GuideStar,¹⁵ various grantmakers, and many other public and private sector entities. An IRS official stated NTEE codes are critical to identify exempt organizations market segments and submarket segments because other identifying methods, such as an organization's name, are not necessarily an indication of its purpose and activities.

Since October 2003, all potential credit counseling applications for tax-exempt status are assigned an initial tracking code on the EO function's application inventory system by EO function Determinations office staff. When the application request is closed by EO function personnel (i.e., a determination letter is issued to the organization), the NTEE code is entered on the inventory system to indicate the organization's activity based on information reviewed during the determination process. Generally, NTEE Code P51¹⁶ is assigned to credit counseling activities. Tax-exempt organizations are required to notify the EO function of changes to the types of services provided; at that time, EO function personnel will change the NTEE code, if applicable.

As part of the Credit Counseling Compliance Project, EO function personnel analyzed their computer systems to identify the total population of approved tax-exempt credit counseling organizations. EO function management stated the identification of credit counseling organizations was difficult because they needed to research various coding systems to identify a potential universe of credit counseling organizations. Prior to the use of NTEE codes, the IRS relied on activity codes to identify the primary activity of organizations applying for tax-exempt status. The NTEE coding system was phased into the IRS' coding methodology and became the primary classification tool in the late 1990s to categorize the activity of new organizations applying for tax-exempt status. Based primarily on NTEE codes, activity codes, and the name of the organization contained on its computer systems, EO function management

¹² The NTEE offers a definitive classification system for nonprofit organizations recognized as tax exempt under the I.R.C. These charitable organizations are exempt from Federal taxes because of their religious, educational, scientific, and public purposes. The broad range of their activities includes health, human services, arts and culture, education, research, and advocacy. The use of the NTEE is key to illuminating the diversity of the nonprofit sector.

¹³ The Statistics of Income Division conducts the IRS' studies on the operations of the tax laws with respect to individuals, corporations, partnerships, sole proprietorships, estates, exempt organizations, trusts, and the international area.

¹⁴ The Urban Institute is a nonpartisan economic and social policy research organization.

¹⁵ GuideStar is a leader in providing comprehensive data on more than 1.5 million nonprofit organizations, connecting them with donors, foundations, businesses, and governing agencies in a nationwide community of giving.

¹⁶ P51 **Financial Counseling** - Organizations that provide advice and guidance for people who need assistance in obtaining credit, obtaining or correcting information in their credit records, reducing their debt burden, or managing their financial resources more effectively.



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identified a potential population of 788 approved tax-exempt credit counseling organizations. However, this population did not contain accurate information at the time of our review. EO function management stated the various coding systems may have contributed to potential inaccuracies of the population. For example, an organization involved in credit counseling activities may not have been coded with NTEE Code P51 because the organization's original activity was not identified as credit counseling on its initial application request for tax-exempt status. In addition, an organization involved in credit counseling activities may not have a NTEE code on the IRS computer system because the original application for tax-exempt status was received before the use of NTEE codes was adopted by the IRS. Based on our review of coding information contained on the IRS database of credit counseling organizations, we determined:

- The NTEE code for 162 (21 percent) of the 788 organizations was not P51. Based upon our review of the information contained on the IRS inventory database, many of these organizations appear to be involved with credit counseling activities.
- An initial IRS analysis conducted in 2004 determined 96 organizations included in a preliminary universe of credit counseling organizations may be inaccurate. However, 89 of these organizations were still included on the EO function's current inventory of 788 credit counseling organizations at the end of our fieldwork and should be reviewed to determine whether they are accurately coded on the inventory system.
- Five of the 62 credit counseling organizations currently under examination for suspected abuses were not initially included as part of the 788 organizations. EO function personnel subsequently added these five cases to ensure they were included in the overall inventory. However, these cases have not been updated with NTEE Code P51.

In addition, the EO Referral and Claims Classification Unit had received 110 referrals of organizations engaging in potentially abusive credit counseling activities since April 2000. Some of these organizations are currently under examination, and others have been identified by EO function management for examination in future years. However, we determined that 9 of the tax-exempt organizations identified for future compliance activity are not included in the population of 788 organizations.

Further, we identified a decision by EO function management that resulted in inconsistent credit counseling data on the IRS inventory system. Specifically, around February 2005, EO function personnel in Washington, D.C., directed EO function Determinations office personnel in Cincinnati, Ohio, to use NTEE Code P50¹⁷ to close credit counseling applications that do not require further scrutiny by the EO Technical office in Washington, D.C. These would generally include credit counseling organizations involved primarily in financial literacy (education)

¹⁷ P50 **Personal Social Services** - Organizations that provide a variety of personal social services, such as, assertiveness training, personal enrichment, sensitivity training, and individual development.



Abuses in the Tax-Exempt Credit Counseling Industry Are Being Addressed, but Further Actions Are Needed to Ensure Overall Industry Compliance

services and not debt management plans. EO Technical office personnel believed this change was necessary at the time to distinguish potentially abusive credit counseling organizations from those involved in financial literacy.

However, we believe these organizations meet the definition of credit counseling organizations and should be coded with NTEE Code P51. As a result, credit counseling organizations engaging in similar activities may have different NTEE codes on the EO function computer system. This coding change, which was still in effect at the end of our fieldwork, will affect the IRS' ability to accurately determine the population of tax-exempt credit counseling organizations. Furthermore, the EO function's use of NTEE Code P50 is not consistent with the standard practice involved in the use on this Code. Specifically, NTEE Code P50 relates to a variety of personal social services, not financial activities.

We identified 28 credit counseling applications processed during the period October 1, 2003, through August 8, 2005, that were coded with NTEE P50 and judgmentally sampled 15 of these cases to determine the primary activity of the organizations. Based on Internet research, we determined that six of these organizations were involved in credit counseling activities. We believe these six cases should have been closed using NTEE Code P51 to ensure consistency on the EO function inventory system. We could not determine the primary activity of the remaining nine organizations due to the lack of documentation or information available on the Internet.

EO function management should update and formalize procedures for processing applications for tax-exempt status by credit counseling organizations

As part of the Credit Counseling Compliance Project, EO function management has developed guidelines on how to process requests for tax-exempt status from credit counseling organizations. However, these guidelines were generally informal in nature, and some were shared with applicable EO function personnel either verbally or via email. This presents a risk that EO function personnel may process requests inconsistently if they did not receive or correctly understand all the informal guidelines. EO function management should update and formalize its procedures related to the screening, processing, and closing of applications for tax-exempt status to ensure EO function personnel process credit counseling applications consistently. Specifically:

- The procedures followed by EO function Determinations office personnel ("screeners") who initially review applications for tax-exempt status should be reconsidered to improve the effectiveness of the research. In August 2004, these screeners were provided, via email, a list of 12 key words to help identify potential credit counseling applications. In June 2005, an additional seven key words were provided via email for use in identifying potential credit counseling organizations involved in bankruptcy services. These applications were then sent to the specialized Determinations office group for review. While we recognize the importance of identifying a broad population of potential credit counseling applications, we believe the current process should be improved to more



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effectively identify actual credit counseling applications. This will provide EO function management with more accurate information related to the number of credit counseling applications received, as well as reduce the workload of the specialized group.

For example, during the period October 1, 2003, through October, 18, 2005, screeners identified 1,081 initial applications using these key words, and the applications were assigned to the specialized group to review as potential credit counseling organizations. Of these, 686 (63 percent) have been closed and the remaining 395 were still open at the end of our fieldwork. However, only 129 (19 percent) of the 686 closed initial applications were assigned NTEE Code P51 relating to credit counseling, with the remainder showing a different NTEE code (not relating to credit counseling). This indicates the current screening process does not use good indicators for identifying possible credit counseling organizations. EO function management should assess the effectiveness of the key words used to identify potential credit counseling organizations and issue formalized guidelines containing the most productive manner to identify these cases.

- A documented training guide should be developed to ensure EO function Determinations office specialists follow consistent procedures when processing applications for tax-exempt status by credit counseling organizations. During FY 2005, a realignment of the Cincinnati, Ohio, Determinations office resulted in three staff members, new to credit counseling, being assigned to the specialized group to process credit counseling applications. These employees had to rely primarily on informal or verbal instruction to review credit counseling applications. A formal written training guide would help ensure staff follow consistent and proper procedures when credit counseling applications are processed. For example, Internet research is a valuable tool used by Determinations office specialists to determine whether applications for tax-exempt status should be approved or denied. Internet research is used to compare the data on the application against the information listed on the applicant's web site, if available. EO Determinations office specialists stated that the EO Technical office provided initial training on a face-to-face basis on how to perform Internet research for the credit counseling applications. After we provided EO function management with a preliminary draft report, they provided us with a one-page document containing limited guidelines for performing Internet research for credit counseling applications. EO function management stated this document was provided to EO Determinations office specialists during the initial training provided by the EO Technical office. However, we believe more detailed guidance is needed to ensure the best practices identified among the group can assist Determinations office personnel in ensuring applications are reviewed in the most effective manner.



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Credit counseling organizations that were provided an initial classification as a public charity when approved for tax-exempt status were not always being reviewed by the specialized Determinations office group for potential abusive activities

If organizations meet the requirements of the law and have completed at least 8 months of their first year of operation, Determinations office specialists will provide a definitive ruling to approve tax-exempt status. Conversely, advance rulings, based on Department of the Treasury Regulations, are given when organizations have not completed a tax year of at least 8 months. In an advance ruling, charitable organizations are granted a determination that they will be considered to be publicly supported tax-exempt organizations during a specified “advance ruling” period. The advance ruling period is usually 5 years from the date of formation of the exempt organization. At the end of the advance ruling period, EO function personnel request that the organizations substantiate the amount of public support they have received for the 5-year period.

The EO function was not ensuring all advance ruling cases related to credit counseling organizations were reviewed by the specialized Determinations office group to identify any potential abuses, as required by EO function procedures. Specifically, we reviewed 13 advance ruling cases to determine if they were assigned to the specialized group responsible for further scrutiny of all credit counseling applications. We determined that none of the 13 closed cases were reviewed by the specialized group and were closed by other EO function personnel. EO function management should reemphasize these procedures to ensure these types of cases receive the appropriate scrutiny to increase assurances that any potential abuses are identified and referred to the appropriate group for review.

Recommendations

Recommendation 1: The Director, EO, should take the following actions to ensure the EO function inventory system contains accurate information related to tax-exempt credit counseling organizations:

- Review the improperly coded cases identified by the Treasury Inspector General for Tax Administration and ensure these cases are correctly coded on the EO function inventory system as credit counseling organizations or other organizations, as appropriate.
- Review the population of 788 organizations included on the EO function inventory of credit counseling organizations and ensure this inventory contains only credit counseling organizations with the proper NTEE code.
- Develop procedures to ensure the EO function credit counseling inventory is accurately updated for referrals of credit counseling organizations engaging in potentially abusive activities.



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- Discontinue the use of the NTEE Code P50 for credit counseling organizations granted tax-exempt status. The inventory system should be updated to change the NTEE Code P50 to P51 for credit counseling organizations, to ensure an accurate and complete population.

Management's Response: IRS management agreed with this recommendation. EO function management will review codes for the credit counseling population to ensure they are accurate. Also, EO function management will develop procedures to review incoming referrals of organizations conducting credit counseling activities to ensure they are accurately coded. In addition, EO function management has issued a directive discontinuing the use of NTEE Code P50 for organizations conducting credit counseling activities and will change the NTEE Code P50 to P51 to ensure an accurate and complete population.

Recommendation 2: The Director, EO, should finalize and implement the draft strategic plan outlining additional actions for addressing credit counseling abuses in the future to ensure the rest of the tax-exempt credit counseling industry is in compliance and any new organizations are appropriately reviewed.

Management's Response: IRS management agreed with this recommendation. EO function management is finalizing and implementing a strategy to address credit counseling abuses in the future to ensure the credit counseling industry is in compliance and any new organizations are appropriately reviewed.

Recommendation 3: To ensure the consistent processing of applications for tax-exempt status by credit counseling organizations, the Director, EO, should update and formalize procedures to process applications and related training guides as follows:

- Develop formalized guidelines containing the most productive manner to review applications for tax-exempt status to identify potential credit counseling organizations. EO function management should also assess the effectiveness of the key words used to search for potential credit counseling organizations to determine whether they can be refined.
- Develop formalized procedures on how best to perform Internet research and include these in an updated training guide for processing credit counseling cases.
- Reemphasize the use of procedures for the processing of advance ruling credit counseling cases.
- Develop procedures to ensure approved applications for tax-exempt status by credit counseling organizations are coded with NTEE Code P51 for consistency on the EO function's inventory system.



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Management's Response: IRS management agreed with this recommendation. EO function management will incorporate training guidelines and Internet training into a formal training package for the review of credit counseling applications. EO function management has issued a directive to reemphasize the use of procedures for processing advance ruling cases. EO function management has procedures in place to ensure approved applications are coded with NTEE Code P51 for consistency on the inventory system and has issued a directive to discontinue the use of NTEE Code P50 for organizations conducting credit counseling activities.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the Exempt Organizations (EO) function's efforts to address abusive activities by tax-exempt credit counseling organizations. Due to resource limitations, we did not perform audit tests to determine the reliability of the information contained in the databases obtained from the EO function. To accomplish this objective, we:

- I. Obtained statistical data on the credit counseling industry and EO function management's oversight of the credit counseling area.
 - A. Researched available data to determine the number of credit counseling organizations currently granted tax-exempt status and the amount of revenue associated with these organizations.
 - B. Obtained available data from EO function management that showed the number of applications for tax-exempt status received from credit counseling organizations for the period October 1, 2003, through October 18, 2005, and the disposition/status of these applications.
 - C. Obtained available data from EO function management that showed the number of examinations conducted on credit counseling organizations as of September 30, 2005, and the disposition of these examinations.
- II. Assessed the method for processing requests for tax-exempt status from credit counseling organizations to determine if EO function management is detecting and deterring abusive credit counseling activities.
 - A. Interviewed applicable EO function management to determine the current method and procedures followed when processing applications for tax-exempt status by credit counseling organizations.
 - B. Determined any recent changes implemented by EO function management to process applications for tax-exempt status by credit counseling organizations.
 - C. Identified planned changes by EO function management to process these types of applications.
 - D. Determined training provided by EO function management regarding how these types of applications should be reviewed.
 - E. Determined if any emerging issues or trends identified during the determination process have been shared with other EO functions.



Abuses in the Tax-Exempt Credit Counseling Industry Are Being Addressed, but Further Actions Are Needed to Ensure Overall Industry Compliance

- F. Reviewed the Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (Form 1023) (Rev. October 2004) to determine if the October 2004 changes to the Form will assist EO function management in developing information about potentially abusive credit counseling areas.
 - G. Determined if advance ruling cases related to credit counseling organizations were reviewed by the specialized Determinations office group as required. We obtained an Employee Plans and Exempt Organizations Determination System (EDS) computer listing and reviewed all 13 advance ruling cases that were merit closed¹ during the period January through June 15, 2005.
 - H. Obtained and reviewed a judgmental sample of 15 of the 28 credit counseling applications contained on an EDS extract that were processed during the period October 1, 2003, through August 8, 2005, and coded as personal social services to determine the primary activity of the organizations. We used a judgmental sampling methodology due to time constraints and because we did not plan to project our audit results.
 - I. Obtained and reviewed the EO function inventory of approved tax-exempt credit counseling organizations to determine if it contained accurate coding information.
 - J. Obtained and reviewed an extract from the EO Referral and Claims Classification Unit database to identify organizations referred to the IRS as engaging in potentially abusive credit counseling organizations from April 2000 through September 1, 2005.
- III. Assessed EO function management's process for conducting audits of credit counseling organizations.
- A. Interviewed applicable EO function management to determine the current process and procedures followed when conducting examinations of credit counseling organizations.
 - B. Determined any recent changes implemented by EO function management to conduct examinations of credit counseling organizations.
 - C. Identified any planned changes by EO function management to examine these types of organizations.
 - D. Determined training provided by EO function management regarding how these types of organizations should be examined.

¹ Merit closures are made when EO function personnel approve an application for tax-exempt status based on the information submitted, without requesting additional information from the applicant and without assigning the case to a specialist.



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- E. Determined the status of EO function management's ongoing examinations of credit counseling organizations and results as of September 30, 2005.
 - F. Determined if credit counseling abuses identified in examinations performed as of September 30, 2005, have been provided to Rulings and Agreements office personnel to improve the effectiveness of the determination process in detecting and deterring potentially abusive credit counseling organizations.
- IV. Assessed EO function management's efforts to coordinate with State officials and other Federal agencies to better address potentially abusive credit counseling organizations.
- A. Interviewed EO function management to identify any actions taken to improve coordination with any State or other Federal agency.
 - B. Determined any actions planned by EO function management to better coordinate with State or Federal agencies in the future.



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Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
Nancy A. Nakamura, Director
Jeffrey M. Jones, Audit Manager
Kenneth C. Forbes, Lead Auditor
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Carol A. Rowland, Auditor



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Appendix III

Report Distribution List

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Abuses in the Tax-Exempt Credit Counseling Industry Are Being Addressed, but Further Actions Are Needed to Ensure Overall Industry Compliance

Appendix IV

Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 227 tax-exempt organizations affected (see page 9).

Methodology Used to Measure the Reported Benefit:

We obtained a Return Inventory Control System extract that identified, as of November 16, 2005, a universe of 788 tax-exempt credit counseling organizations. In addition, we obtained a data extract from the Exempt Organizations (EO) function Referral and Claims Classification Unit database that identified 110 referrals of organizations referred to the EO function from April 2000 through September 1, 2005, as engaging in potentially abusive credit counseling activities. Further, we judgmentally sampled 15 cases that were closed with National Taxonomy of Exempt Entities (NTEE)¹ Code P50 to determine the primary activity of these organizations. Based upon our review of coding information contained on the Internal Revenue Service (IRS) database of credit counseling organizations, we determined:

- **162** (21 percent) of the 788 credit counseling organizations were not coded with NTEE Code P51. Based upon our review of the information contained on the IRS inventory database, many of these organizations appear to be involved with credit counseling activities.
- **50** of the 788 organizations may not be credit counseling organizations. An initial IRS analysis conducted in 2004 determined that 96 organizations included in a preliminary universe of credit counseling organizations may be included erroneously. However, 89 of these organizations were still included on the EO function's current inventory of 788 credit counseling organizations. We eliminated 39 of these organizations because they were also included in the 162 organizations that were not coded with NTEE Code P51, leaving 50 additional organizations not correctly coded.

¹ The NTEE offers a definitive classification system for nonprofit organizations recognized as tax exempt under the Internal Revenue Code.



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- **9** of the 110 organizations referred to the IRS as engaging in potential abusive credit counseling activities have been identified for future compliance activity but are not included in the population of 788 organizations.
- **6** of the 15 sampled cases were involved in credit counseling activities and should have been closed using NTEE Code P51 to ensure consistency on the EO function inventory system.

(162 + 50 + 9 + 6 = 227 organizations with potentially inaccurate information on the EO function inventory system).



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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

RECEIVED
APR 25 2006

APR 24 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: 
Steven T. Miller
Commissioner, Tax Exempt and Government Entities Division

SUBJECT: Draft Audit Report – Abuses in the Tax-Exempt Credit Counseling Industry are being addressed, but further actions are needed to ensure overall Industry Compliance (Audit # 200510020)

I am responding to your report on the effectiveness of the Exempt Organization (EO) function's program to address abusive activities by tax-exempt credit counseling organizations.

Addressing abuse within the credit counseling industry has been an important initiative for the Exempt Organizations function of the Tax Exempt and Government Entities Division (TE/GE). We have worked hand-in-hand with the Federal Trade Commissioner, the National Association of State Charity Officials, and others, to combat abuses in the credit counseling industry. We appreciate your recognition of the numerous steps we have taken to end this abuse, and we appreciate your recommendations for perfecting our program.

Before responding to the corrective actions, we wish to offer two observations.

First, we want to clarify the selection process for identifying the credit counseling population. Your report indicates that some of the credit counseling organizations in our population were not coded under the NTEE Code for credit counseling activity. That is correct. However, we did not rely solely on NTEE Codes to select the credit counseling population. The IRS coding systems for identifying specific activities had changed in recent years, and the old and new systems were not necessarily wholly consistent. Consequently, we employed a multi-step process to identify the universe of tax-exempt credit counseling organizations. First, we performed several searches in both the old and new coding systems. To ensure that organizations selected were, in fact, credit counseling organizations, and to retrieve the names of credit counseling organizations that might not have shown up in the first searches because they had not been properly coded, we also performed computerized word searches of IRS databases containing the names of tax-exempt organizations. We conducted searches using such terms as



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“credit counsel,” “debt manage,” or “debt negotiate.” By combining and comparing the information obtained through all these searches, we identified a reliable universe of known tax-exempt credit counseling organizations.

Second, the report correctly points out that, during the Credit Counseling Initiative, the IRS did not consistently code all approved credit counseling applications under the NTEE Code for credit counseling activity, Code P51. We also used Code P50 so we could more readily distinguish between those credit counseling organizations that exhibited predictors of potentially abusive practices and those that did not. We felt that the use of different codes would make it easier to accurately determine the number and profile of each type of credit counseling organization in future compliance action. At this point, however, we accept your recommendation, and will take the steps indicated below.

Our responses to your recommendations follow:

RECOMMENDATION ONE

The Director, EO should take the following actions to ensure the EO function’s inventory system contains accurate information related to tax-exempt credit counseling organizations:

- 1.1 Review the improperly coded cases identified by the Treasury Inspector General for Tax Administration and ensure these cases are correctly coded on the EO function’s inventory system as credit counseling organizations or other organizations, as appropriate.
- 1.2 Review the population of 788 organizations included in the EO function’s inventory of credit counseling organizations and ensure this inventory contains only credit counseling organizations, or other organizations, as appropriate.
- 1.3 Develop procedures to ensure the EO function’s credit counseling inventory is accurately updated for referrals of credit counseling organizations engaging in potentially abusive activities.
- 1.4 Discontinue the use of the NTEE Code P50 for credit counseling organizations granted tax-exempt status. The inventory system should be updated to change the NTEE Code P50 to P51 for credit counseling organizations to ensure an accurate and complete population.

CORRECTIVE ACTIONS

- 1.1 and 1.2 We will review codes for the credit counseling population to ensure they are accurate.
- 1.3 We will develop procedures to review incoming referrals of organizations conducting credit counseling activities to ensure they are accurately coded.



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1.4 The Director, EO Rulings and Agreements already has issued a directive discontinuing the use of the NTEE Code P50 for organizations conducting credit counseling activities. We will update the inventory system to change the NTEE Code P50 to P51 for credit counseling organizations to ensure an accurate and complete population.

IMPLEMENTATION DATES

1.1 and 1.2 January 31, 2007

1.3 October 31, 2006

1.4 April 19, 2006 – Discontinued the use of NTEE Code P50
September 30, 2006 – Update Inventory System

RESPONSIBLE OFFICIALS

1.1, 1.2, and 1.3 Director, EO Examinations

1.4 Director, EO Rulings & Agreements

RECOMMENDATION TWO

The Director, EO should finalize and implement the draft strategic plan outlining additional actions for addressing credit counseling abuses in the future to ensure the rest of the tax-exempt credit counseling industry is in compliance and any new organizations are appropriately reviewed.

CORRECTIVE ACTIONS

We are finalizing and implementing our strategy to address credit counseling abuses in the future to ensure the rest of the tax-exempt credit counseling industry is in compliance and any new organizations are appropriately reviewed.

IMPLEMENTATION DATE

June 30, 2006

RESPONSIBLE OFFICIALS

Director, EO

RECOMMENDATION THREE

To ensure the consistent processing of applications for tax-exempt status by credit counseling organizations, the Director, EO, should update and formalize procedures to process applications and related training guides, as follows:

3.1 Develop formalized guidelines containing the most productive manner to review applications for tax-exempt status to identify potential credit counseling organizations. EO function management should also assess the effectiveness of the key words used to



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search for potential credit counseling organizations to determine whether they can be refined.

3.2 Develop formalized procedures on how best to perform Internet research and include these in an updated training guide for processing credit counseling cases.

3.3 Re-emphasize the use of procedures for the processing of advance ruling credit counseling cases.

3.4 Develop procedures to ensure approved applications for tax-exempt status by credit counseling organizations are coded with NTEE Code P51 for consistency on the EO function's inventory system.

CORRECTIVE ACTIONS

3.1 and 3.2 We will incorporate training guidelines on reviewing credit counseling applications and updated Internet training into a formal training package. We will continue to assess the effectiveness of the key words used to search for potential credit counseling organizations

3.3 The Manager, EO Determinations, issued a directive on April 24, 2006, re-emphasizing the use of procedures for processing advance ruling credit counseling cases.

3.4 We have procedures in place to ensure that approved applications for tax-exempt status by credit counseling organizations are coded with NTEE Code P51 for consistency on the EO function's inventory system. As noted above the Director of EO Rulings and Agreements issued a directive on April 19, 2006, discontinuing the use of the NTEE Code P50 for organizations conducting credit counseling activities.

IMPLEMENTATION DATES

3.1 and 3.2 October 31, 2006

3.3 Completed - April 24, 2006

3.4 Completed - April 19, 2006

RESPONSIBLE OFFICIALS

3.1, 3.2, and 3.4 Director, EO Rulings & Agreements

3.3 Manager, EO Determinations

MEASURABLE BENEFIT ON TAX ADMINISTRATION

We concur with TIGTA's estimate of the potential benefit of its recommendations on tax administration.