



INDEPENDENT SECTOR
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Tips for Public Charities and Private Foundations Regarding Charitable Provisions in the Pension Protection Act of 2006

On August 17, 2006, President Bush signed into law pension reform legislation that includes a package of charitable giving incentives and safeguard measures to protect charitable organizations and assets. The following information is designed to help charitable organizations evaluate how they might be affected by the new provisions. **This information is offered as general guidance about the new law and should not be considered a substitute for professional counsel. Nonprofits should consult their tax or legal advisors for professional guidance.**

Also, see the [IRS website](#) for the latest guidance on charitable provisions in the Pension Protection Act.

IRA Rollover

This long-sought giving incentive permits donors who are 70½ and older to make contributions totaling up to \$100,000 directly to public charities both from a traditional IRA or Roth IRA without having to count the donation as taxable income. Contributions to supporting organizations, donor-advised funds, and private foundations, except in narrow circumstances, do not qualify for this new enhanced deduction. The provision takes effect immediately, but expires on December 31, 2007.

Charities interested in taking advantage of this new incentive in their fundraising efforts should be sure to advise their donors to consult with their own professional tax or legal counsel to ensure that their gifts will qualify under this new provision. Supporting organizations should work with their supported organizations to provide the most advantageous opportunities to their donors. See [Independent Sector's website](#) for more information on the IRA charitable rollover.

Contributions of Clothing and Household Items

Effective immediately, taxpayers who itemize deductions on their annual income taxes may only claim deductions for donated clothing and household items that are in good used condition. In addition, the Treasury Secretary may prohibit deductions for any item with minimal monetary value, such as used socks or undergarments. Donors who contribute a single piece of clothing or a household item for which a deduction of more than \$500 is claimed are now required to file a qualified appraisal of the donated item with their tax returns. Taxpayers who claim deductions for non-cash contributions totaling more than \$500 must still submit a copy of IRS Form 8283, *Noncash Charitable Contributions*, with their tax returns.

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Charities must now file Form 8282, *Donee Information Return*, if they sell or dispose of donated items valued at more than \$500 within **three** years after they received the donation, unless the item was consumed or distributed for charitable purposes. Charities are subject to substantial penalties if they fraudulently claim that an item was used for charitable purposes to support a larger tax deduction by the donor.

The new provision does not apply to donations of jewelry and gems, collections, paintings, antiques, and other objects of art. For further information about specific rules and regulations applying to these types of donations, see IRS publication 561, [Determining the Value of Donated Property](#).

Charities that accept donations of clothing and household items should make donors aware of the new requirements, and may wish to institute new procedures to reject donations that cannot be sold or used by the organization in its charitable programs. Charities should also be alert to any new requirements issued by the Treasury Department regarding procedures for accepting donated household and clothing items and the receipts that charities must provide to donors for such items.

Substantiation of Cash Contributions

Effective January 1, 2007,* donors who itemize deductions on their annual income tax returns must have a bank record or a written communication from the charity to substantiate any cash contributions. The charity's communication, such as a receipt or a letter, must indicate the name of the charity, the date of the contribution, and the amount of the contribution. Donors will no longer be able to claim deductions based solely on their own written records, such as a contemporaneous diary noting donations. Charities are still required by law to provide such documentation to donors for gifts of \$75 or more if they provided a return benefit to the donor (such as a meal or a token gift). For gifts over \$250, the charity must provide a written acknowledgment indicating whether or not the donor received a return benefit. While not required by law, charities should now be prepared to provide receipts for any cash donation if requested by the donor.

**This provision may take effect sooner for individuals whose tax year does not follow the calendar year. Consult your tax or legal advisor for professional guidance.*

Food Inventory Donations

Nonprofits that accept food donations should be aware that effective immediately all businesses may claim an enhanced deduction for donations of food inventory. This incentive was previously in effect in the fall of 2005 under the Katrina Emergency Tax Relief Act.¹ This provision is eagerly welcomed by food banks such as America's Second Harvest because of the significant increase in food donations that will likely result, but is only in effect until December 31, 2007.

¹ Public Law No: 109-73

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Contributions of Façade/Conservation Easements

Effective immediately, only those public charities with a purpose of environmental protection or historic preservation that also have the commitment and resources to manage and enforce easement restrictions may accept tax-deductible contributions of facade/conservation easements to buildings located in a registered historic district. Donors who contribute such façade/conservation easements are now required to preserve the entire exterior of the building (e.g. front, sides, rear, and height) and are prohibited from changing or altering the building's exterior in a way inconsistent with its historical character. There must be a written agreement between the donor and the charity specifying the terms of the easement donation and the charity's responsibilities to enforce those terms. Donors claiming the deduction must file with their tax returns certain documentation including a qualified appraisal of the donated façade/conservation easement and photographs of the building's exterior.

Effective August 17, 2006, the provision also specifies that the charitable deduction is reduced if a rehabilitation tax credit has been claimed with respect to the donated property. For contributions made after February 13, 2007, donors claiming a deduction in excess of \$10,000 must pay a \$500 filing fee to the IRS.

Contributions of Property for Conservation Purposes

Effective immediately, taxpayers who donate property for conservation purposes may deduct the fair market value of the property up to 50 percent of their adjusted gross income in the first year and can carry over the remaining value to claim deductions over the next 15 years (10 years longer than current law). Qualifying farmers and ranchers who donate land for conservation purposes may deduct up to 100 percent of their annual adjusted gross income so long as the land remains available for agricultural or livestock production purposes. The new rules apply to contributions made during 2006 and 2007.

Appraisals for Valuations of Certain Donated Property

Effective immediately, taxpayers who claim deductions for donations of property (including works of art, collectibles, land, etc.) valued at \$5,000 or more will be subject to more stringent appraisal requirements to substantiate the value of the property. New thresholds for imposing penalties are also in place, and the amount of penalties that can be imposed for gross misstatements of the value of the property is increased.

While the changes in the rules do not directly affect charitable organizations that receive such gifts, many charities may wish to advise their donors that the rules have changed and encourage them to consult their own tax and legal advisors to determine the appropriate actions required to substantiate a claim for tax deductions. See [IRS Notice 2006-96](#) (PDF) for guidance on new appraisal rules.

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Fractional Interest Donations

Effective immediately, charities that accept donations of a fractional interest in an item of tangible personal property (such as artwork or collectibles) must take possession of the item at least once during 10 years after the donation and use it for the organization's exempt purpose, and take complete ownership of the item within 10 years of the initial donation or at the death of the donor (whichever comes first). Donors who make subsequent donations of partial interest in the same property will only be able to take tax deductions for the **lesser** of the fair market value of the item at the time of the first donation or at the time of the subsequent donation. Charities should consult with their tax or legal advisors before entering into agreements with donors for fractional interest donations.

Notification Requirement for Entities Not Currently Required to File and Penalty for any Organization Failing to File a Form 990 for Three Consecutive Years

Effective January 1, 2007, nonprofits that are not currently required to file a Form 990 because their annual revenues are less than \$25,000 will be required to submit an electronic report to the IRS. The IRS is in the process of designing the new form, which will include the organization's name, mailing address, and other specified information and must notify charities of the new filing requirement procedures "in a timely manner." There are no monetary penalties for failure to file the notice, but the IRS may revoke the tax-exempt status of any organization that does not file the form for three consecutive years.

Failure to file either the Form 990 or the new annual notice for three consecutive years will result in revocation of tax-exempt status. After the loss of exempt status, the organization may apply to the Secretary for reinstatement of its tax-exemption. The IRS is required to notify every organization of the new notice requirement by mail, by Internet or by other means of outreach and to publicize the new penalty for consecutive failures to file either the new notice or the Form 990. *Effective for notices and returns with respect to annual periods beginning after 2006*

Public Disclosure of UBIT Returns

Effective immediately, charities that file Unrelated Business Income Tax (UBIT) returns (Form 990-T) must make those returns available for public inspection and disclosure on the same basis as their Form 990 returns. However, nonprofits may remove certain proprietary business information from the Forms before making them available to the public. A certification requirement that was included in earlier legislation is not included in the final law.

Donor-Advised Funds

Public charities that offer donors the opportunity to establish separate funds within their organization where the donor retains the right to advise the charity on how those funds should be distributed or invested should pay close attention to the new requirements for donor-advised funds. See [IRS Notice 2006-109](#) (PDF) for interim guidance on complying with these requirements.

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Funds that make distributions only to a single identified organization or government entity are not considered to be donor-advised funds. Funds that provide grants to individuals for travel, study, or similar purposes are also not considered to be donor-advised funds if the donor's advisory privileges are limited to serving as a member of a committee appointed by the sponsoring charity, if such committee is not controlled directly or indirectly by the donor and parties related to the donor, and if grants are awarded on an objective and nondiscriminatory basis. The Treasury Secretary may also delineate other exceptions to the definition of a donor-advised fund if the fund benefits a single, identified charitable purpose (such as a fund for the arts or education) and is advised by a committee not directly or indirectly controlled by the donor and individuals related to or appointed by the donor.

Effective February 13, 2007, when a charity accepts a donation for a donor-advised fund, it must have a written agreement with the donor specifying that the charity has exclusive legal control over the contributed funds or the donor will not be able to claim a tax deduction for the contribution.

Effective immediately, charities that hold donor-advised funds must institute procedures to ensure that no grants, loans, compensation, or other payments are made from the fund to donors, donor advisors, parties related to the donor and donor advisors, or investment advisors who are related to or controlled by the donor, donor advisors, or related parties. This includes reimbursement of expenses incurred by donors and related parties to inform their advice to the sponsoring charity or to raise additional funds for the donor-advised fund.

When charities make grants from donor-advised funds to international and domestic organizations that are not organized as public charities under U.S. laws, they must exercise "expenditure responsibility" to ensure that the funds are used for the designated charitable purpose.

Charities that hold or sponsor donor-advised funds will be required to report on their annual Form 990 return the number of funds they own, the total value of assets in those funds, and the total contributions to and grants made from those funds during the year.

A donor-advised fund of the charity may not hold alone or in combination with the donor and parties related to the donor more than 20 percent voting interest in a for-profit business and must dispose of any excessive interest within five years of the donation. The Treasury Secretary will be able to provide a five-year extension of that deadline if the charity can demonstrate just cause. The Treasury Secretary can also raise the 20 percent limit to 35 percent if it can be demonstrated that the for-profit business is controlled by a third party unrelated to the organization of its disqualified persons.

Supporting Organizations

Effective immediately, a public charity that is recognized by the IRS as a supporting organization (under section 509(a)(3) of the tax code) must provide on its next annual Form 990 return a list of all of its supported organizations, an indication of the type of supporting organization it is, and a statement that the organization is not controlled by

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donors or parties related to the donors. See the IRS website for guidance on determining or changing the status of a supporting organization ([Announcement 2006-93](#)) (PDF) and for interim guidance on changes affecting supporting organizations [IRS Notice 2006-109](#) (PDF).

Also effective immediately, all types of supporting organizations are prohibited from making any payments or loans (including compensation for services) to an individual who is a substantial contributor or is related to a substantial contributor or to a company in which a substantial contributor and related parties own 35 percent or more of the controlling interest.

Special Cautions for Type III Supporting Organizations

The bill establishes a new category for “functionally integrated” Type III supporting organizations. These are organizations that provide services or conduct activities that the supported organization would have to carry out itself if the Type III supporting organization did not exist. The IRS has issued [interim guidance](#) (PDF) on determining which Type III supporting organizations meet this new definition.

Type III Supporting Organizations that are not “functionally integrated” with their supported organizations will be subject to new payout requirements to be determined by the Treasury Secretary. In tax years beginning after August 17, 2006, they will be prohibited from holding alone or in combination with the donor and parties related to the donor more than 20 percent voting interest in a for-profit business and must dispose of any excessive interest within five years of the donation. The Treasury Secretary will be able to provide a five-year extension of that deadline if the charity can demonstrate just cause. The Treasury Secretary can also raise the 20 percent limit to 35 percent if it can be demonstrated that the for-profit business is controlled by a third party unrelated to the organization of its disqualified persons.

Also effective immediately, donors will not receive a tax deduction for contributions to donor-advised funds held by Type III supporting organizations that are not “functionally integrated” with their supported organizations.

Special Cautions for Private Foundations

Private foundations may no longer count grants or payments to Type III supporting organizations that are not “functionally integrated” as part of their qualifying distributions.

Private foundations also may no longer count as qualifying distributions grants or payments to any supporting organization that is directly or indirectly controlled by individuals who are “disqualified persons” of the foundation.

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