Charitable Giving Provisions for Individuals in the Pension Protection Act of 2006

The Pension Protection Act of 2006 contains important provisions designed to encourage charitable contributions by individuals. Below is our summary of the charitable contribution provisions of the Pension Act, including some suggestions for how these provisions can be used to your advantage.

Tax-Free Distributions from IRAs

Effective for a two-year period (January 1, 2006-December 31, 2007), distributions made from an IRA to a qualifying charity are excluded from the income of the IRA owner. The owner must be at least age 70-1/2 to take advantage of this provision, and the amount excluded is limited to $100,000 per year. This provision removes a number of impediments that stood in the way of IRA owners who wanted to give all or a portion of their IRA to charity. Under the usual rules, a gift from an IRA to charity is treated as a taxable distribution to the owner, who then has to claim an itemized deduction for the gift. Treating the gift as a distribution has adverse tax consequences to the owner, including the possibility of the alternative minimum tax and the loss of itemized deductions and personal exemptions. And because the deduction is limited to 50% of the IRA owner's adjusted gross income, often the owner does not get a full deduction in the year of the gift. These impediments are removed for qualifying owners by treating the distribution as an exclusion from income, rather than as a deduction.

These qualifying IRA distributions will be reported by the IRS to the donor on Form 1099-R as a regular distribution. However, not all amounts reported as regular distributions are subject to income taxation. The IRS reports that there will be procedures on the 2006 Form 1040 for taxpayers who are eligible under this new provision to exclude direct distributions to charities from their IRA.

To qualify for exclusion, the donor must receive a written acknowledgement from the charity confirming the receipt of the direct IRA distribution. The acknowledgement should include 1) the amount received, 2) that it was received directly from the IRA administrator with the intention to qualify as a qualified charitable distribution from your IRA under IRC 408(d)(8), 3) the charity warrants that it qualifies under IRC 170(b)(1)(A) and the gift was not transferred to either a donor advised fund or a supporting organization described in 509(a)(3), and 4) statement that no goods or services were received by the donor in exchange for this contribution.

Cutback on Deductions for Gifts of Tangible Personal Property

Under prior law, a donor of a gift of tangible personal property (i.e., other than cash, securities, or intellectual property) could deduct only the tax basis of the property (rather than its higher fair market value) if the donee charity did not use the property in its exempt function. This restriction is extended by the Pension Act to apply to property that is disposed of by the charity within the same year that it was received. In addition, if the charity disposes of the gifted property in a subsequent taxable year, but within three years of the gift, the IRS will recapture the tax benefit that the donor received in the year he made the gift. The 2 year requirement to file a Form 8282 has been increased to 3 years. These adverse consequences can be avoided if the charity provides a certification that its original intended use of the property became impossible or infeasible. This is effective for contributions made and returns filed after September 1, 2006.

Limitation on Contributions of Household Goods and Clothing

Many taxpayers take advantage of the charitable contribution deduction by making gifts of used clothing and household goods. Due to concern about abuses of this type of deduction, the Pension Act provides that the deduction will be allowed only if the donated clothing or household goods are "in good used condition or better." This provision is effective immediately. It is not clear what Congress meant by "good used condition or better" and it is expected that the IRS will be issuing guidance in this area. Fortunately, the limitation on "good used condition" does not apply to gifts of food, art objects, jewelry, gems, or

collections, as well as to individual items of clothing or household goods with a value of $500 or more that are supported by an appraisal.

Limits on Deduction of Cash Gifts

New recordkeeping requirements in the Pension Act will probably have the effect of disallowing a deduction for small gifts of cash. Under the Pension Act, any gift of money (by cash or check) may be deducted only if it is supported by a bank record or a written acknowledgement from the donee organization. This provision is effective for taxable years beginning after August 17, 2006.

Contributions to Donor-Advised Funds

The Pension Act contains a number of restrictions on so-called "donor-advised funds," which are separately identified accounts funded by a donor and held by a charity for future distribution at the donor's recommendation. The Pension Act provides that a contribution to such a fund will not be deductible unless: (1) the sponsoring organization for the fund is a charity; (2) the sponsoring organization is not a particular variety of Type III supporting organization; and (3) the sponsoring organization provides the donor with a written acknowledgement of the gift that explains that the sponsoring organization has exclusive control over the use of the gift. The purpose of these restrictions is to discourage gifts to organizations that allow the donor excessive control over distributions from the fund. It should have no impact on gifts to mainstream donor-advised funds.

Contributions of Food Inventories

For donations of food inventory, the Pension Protection Act of 2006 contained a charitable deduction provision that extends to all trades and businesses the enhanced deduction equal to the lesser of (i) the taxpayer's basis plus one-half of the difference between fair market value and basis, or (ii) twice the taxpayer's basis in the contributed inventory. Effective for contributions of food inventory made in taxable years beginning after December 31, 2005 and before January 1, 2008. In the past, partnerships and S corporations were limited to their cost. The 501(c)(3) organization receiving the food, among other requirements, must use the property consistent with the organization's exempt purpose solely for the care of the ill, the needy, or infants, not transfer the property in exchange for money or other property or services, and provide the taxpayer a written statement that the use of the contributed food will be consistent with such requirements.

Notification Requirement for Entities Not Currently Required to File

The Act requires certain exempt organizations, those that are not required to file a tax return because their gross receipts are less than $25,000, to file electronically an annual notice with the IRS containing basic contact and financial information. The Act provides for the loss of exempt status for any exempt organization that fails to file a return or notice for three consecutive years. This is effective for notices and returns for annual periods beginning after 2006.

Public Disclosure of Unrelated Business Income Tax Returns

The Act extends the present-law public disclosure requirements applicable to Form 990, Return of Organization Exempt From Income Tax, to the unrelated business income tax returns of §501(c)(3) organizations. Effective for returns filed after August 17, 2006.

IRS Information Reporting – Acquisition of Interests in Certain Life Insurance Contracts

Effective for certain insurance interests acquired from August 17, 2006 to August 17, 2008, the exempt organization must file a return that contains the name, address, and tax ID number of the organization, the insurer, and other information deemed necessary by the IRS. This applies to any life insurance,

annuity, or endowment contract with respect to which both the exempt organization and another person have directly or indirectly held an interest in the contract (whether or not at the same time). Some exceptions apply. Penalty provisions apply for failure to file.

IRS Penalties on Managers Relating to "Excess Benefit" Payments

Excess benefit penalties increased for managers from 10% to 20% of the amount of the excess benefit to a maximum of $20,000 (from $10,000). A "manager" could be a staff member in charge of finances as well as board members.