# PUBLICATION

## Pension Protection Act of 2006

**January 26, 2007**

Congress enacted the Pension Protection Act of 2006 (the "Act"), and President Bush signed it into law on August 17, 2006.

The Act is a massive tax bill that covers a multitude of issues, many of which, in keeping with the popular name of the Act, relate to the overhaul of pensions (or defined benefit plans). In addition, the Act includes a number of significant charitable giving incentives, as well as reforms aimed at certain types of exempt organizations and charitable giving practices.

The Act's charitable giving incentives provide tax advantaged charitable giving opportunities.

The Act's reforms focus mainly on (a) certain types of exempt organizations that have been targeted in the past few years for abusing their taxexempt status and (b) certain charitable giving practices that have likewise been perceived as abusive.

## Charitable Giving Incentives

Under the new Act, for tax years beginning on or after January 1, 2006, a taxpayer who has reached 70-plus years of age may make tax-free distributions of up to $100,000 per year from his or her IRA to most charitable, tax-exempt organizations (distributions made to supporting organizations or into a donor advised fund do not qualify) provided that the distribution is otherwise eligible as a deductible charitable contribution (excluding applicable percentage limitations). Taxpayers cannot "double dip" by also taking a charitable deduction for the tax-free, charitable distribution. In addition, the Act extends favorable rules for charitable deduction of donations of certain food and book inventories through December 31, 2007. Further, the Act implements favorable basis adjustments for holders of S corporation stock making charitable contributions of appreciated property.

## Credit Counseling Organizations

The Act imposes numerous new requirements on tax-exempt credit counseling organizations. The new requirements range from implementing a policy that allows fee waivers for those who are unable to pay for the organization's services to limiting the amount that an exempt credit counseling organization can accept from creditors. In addition, the Act provides that the repayment, consolidation, or restructuring of a consumer's debt and negotiation with creditors on a consumer's behalf are unrelated business activities. Therefore, an organization that provides such services as more than an insignificant part of its overall activities will not qualify as a tax-exempt organization for failure to operate primarily for charitable purposes. The amendments shall apply to taxable years beginning after the effective date of the bill, with an additional one year exception for those organizations qualified under §501(c)(3) or (4) to which credit counseling services is a substantial purpose as of the date of enactment.

## Donor Advised Funds

The Act adds two new sections to the Internal Revenue Code regulating Donor Advised Funds (DAFs). Section 4966 defines DAFs and makes it costly (excise tax) or administratively difficult (expenditure responsibility) to distribute funds from a DAF unless the distribution is being made to (a) the organization that sponsors the

DAF; (b) another DAF, or (c) tax-exempt, public charities (excluding certain types of supporting organizations). Section 4967 imposes an excise tax on any DAF donor or appointee who advises the DAF to make a distribution resulting in more than an incidental benefit to the donor or related parties.

The Act further regulates DAFs by including within the gambit of the intermediate sanctions rules certain transactions involving DAFs and the organizations that sponsor them. In addition, the Act imposes on DAFs the excess business holdings rules applicable to private foundations and requires additional substantiation as a condition to taking income, estate, and gift tax deductions for contributions made to DAFs. Finally, the new Act limits income, estate, and gift tax deductions for contributions made to DAFs which are sponsored by veterans organizations, fraternal societies, cemetery companies, and certain supporting organizations, and requires organizations which are sponsoring DAFs to report such activity.

## Supporting Organizations

The Act includes a number of new provisions applicable to supporting organizations, such as donor restrictions, increased reporting requirements, and, in some instances, required payments to supported organizations.

The Act further regulates supporting organizations by specifying that certain transactions by and between supporting organizations and their substantial donors/disqualified persons are automatically treated as excess benefit transactions. Further, the new Act imposes the excess business holdings rules applicable to private foundations on certain supporting organizations. Finally, the new Act excludes, from qualifying distributions required by private foundations, those distributions which are made to certain supporting organizations.

## Additional Reforms

In addition to those major reforms discussed above, the Act also provides the following changes and amendments:

- *Increased Penalties/Excise Taxes.* The Act increases the excise taxes imposed on private foundations for (a) violation of the self-dealing rules; (b) failure to make minimum distribution; (c) excess business holdings; and (d) making investments in jeopardy of a private foundation's charitable purpose.
- *Limitations on Contributions of Qualified Conservation Contributions.*
- *Reduction/Recapture of Deductions for Charitable Contributions of Certain Tangible Personal Property.* In certain circumstances, the Act requires a reduction in the amount of the charitable contribution (or recapturing the amount of the deduction) by the amount that the contribution/ deduction exceeds the donor's basis in the property
- *Limitations on Deductions for Charitable Contributions of Clothing and Household Items.* The Act prohibits deductions for charitable contributions of clothing and household items which are not in "good used condition or better."
- *Limitations on Deductions for Charitable Contributions of Fractional Interests.* The Act places significant limitations on the income, estate, and gift tax deductions available for charitable contributions of fractional interests in tangible personal property.
- *Valuation of Charitable Contributions of Property.* The Act addresses substantial and gross valuation misstatements of donated property.
- *Regulation of Appraisers/ Appraisals; Penalties.* The Act includes more specific provisions defining qualified appraisals and adds penalties.
- *Definition of Investment Income.* The definition of investment income as applicable to private foundations has been broadened slightly.

- *Notification Requirement for Entities Not Currently Filing IRS Form 990.* Organizations currently not filing IRS Form 990 may now need to file general information electronically.
- *Stricter Substantiation Requirements for Small Monetary Donation.* Taxpayer must have a bank record or receipt for any monetary gift.