# Provisions of Interest to Charitable Organizations and their Donors in H.R. 4, the Pension Protection Act of 2006

August 24, 2006

Congress recently passed the Pension Protection Act of 2006 (H.R. 4) (the "Act"). The Act contains a number of provisions of interest to charitable organizations and their donors. Several of these provisions are summarized below. The Act was formally enacted on August 17, 2006 when President Bush signed it into law. The Act amends and adds several new provisions to the Internal Revenue Code of 1986, as amended (the "Code").

## IRA CHARITABLE ROLLOVER PROVISION

The Act permits individuals who are 70 ½ years or older to exclude from income up to $100,000 annually in "qualified charitable distributions." A qualified charitable distribution is a distribution from certain individual retirement plans to certain public charities or to private operating foundations. Distributions to a donor advised fund, a supporting organization or a private non-operating foundation do not qualify for the income exclusion.

This provision is effective on the date of enactment and expires on January 1, 2008.

## PROVISIONS REGARDING DONOR ADVISED FUNDS

The Act contains detailed provisions regarding donor advised funds, including those summarized below.

### A. Excise Taxes Relating to Donor Advised Funds

The Act adds two new excise taxes relating to donor advised funds.[1] These excise taxes are effective for tax years that begin after the date of enactment.

#### 1. Definition of a Donor Advised Fund and a Sponsoring Organization

Donor advised funds have existed since 1931. More than 80,000 donor advised funds are in use today. For the first time, the Code will define a donor advised fund.[2]

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[1] These excise taxes are found in new Code sections 4966 and 4967.

[2] See Code section 4966(d)(2).

A donor advised fund is defined as any "fund or account (i) which is separately identified by reference to contributions of a donor or donors, (ii) which is owned and controlled by a sponsoring organization, and (iii) with respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor."

The definition excludes any fund which makes distributions only to a single identified organization or governmental entity. It also excludes any fund which makes grants to individuals for travel, study or other similar purposes if (i) the fund is advised by a committee all the members of which are appointed by the sponsoring organization, (ii) the committee is not controlled by the donor or donor advisor to the fund (or any persons related to the donor or donor advisor), and (iii) all grants from the fund are awarded on an objective and non-discriminatory basis pursuant to a procedure approved in advance by the governing board of the sponsoring organization, provided that the procedure meets the requirements for private foundation grants to individuals for travel, study or other similar purposes.[3]

The Secretary of the Treasury may exempt a particular fund from the definition of a donor advised fund if the fund is either (i) advised by a committee not directly or indirectly controlled by the donor or donor advisor to the fund (or any persons related to the donor or donor advisor) or (ii) benefits a single identified charitable purpose. By way of example, this provision will permit a sponsoring organization to request an exemption from the Secretary for a donor advised fund formed to aid individuals affected by a particular natural or civil disaster.

A sponsoring organization is a public charity (other than certain Type III supporting organizations) which maintains one or more donor advised funds.

2. Excise Tax on Taxable Distributions

A sponsoring organization of donor advised funds which makes a "taxable distribution" will be subject to a new excise tax equal to 20% of the amount of the taxable distribution. In addition, any manager[4] of the sponsoring organization who approves a distribution knowing it to be a taxable distribution will be subject to an excise tax equal to 5% of the amount of the taxable distribution, not to exceed $10,000 for any one taxable distribution.

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[3] The requirements for private foundation grants to individuals for travel, study or other similar purposes are found in Code section 4945(g).

[4] For purposes of the excise tax on taxable distributions and the excise tax on prohibited benefits discussed below in Section A.3, a manager is defined as an officer, director or trustee of the sponsoring organization (or an individual having similar powers or responsibilities) and, with respect to any act or failure to act, the employees of the sponsoring organization that have the authority or responsibility with respect to the act or failure to act.

a. Taxable Distributions from a Donor Advised Fund

A taxable distribution is any distribution from a donor advised fund (i) to an individual; or (ii) to any entity if the distribution is not for a charitable purpose. Unless the sponsoring organization exercises expenditure responsibility,[5] a taxable distribution also includes any distribution from a donor advised fund to (i) a private non-operating foundation; (ii) to a Type III supporting organization, other than a "functionally integrated Type III supporting organization"[6]; or (iii) to a Type I or II supporting organization which is directly or indirectly controlled by a donor or donor advisor to the fund (or any persons related to the donor or donor advisor).

b. Permitted Distributions from a Donor Advised Fund

A distribution from a donor advised fund to a public charity (other than certain supporting organizations, as described above) or a private operating foundation is not a taxable distribution. Neither is a distribution from one donor advised fund to another donor advised fund. In addition, a distribution from a donor advised fund to a foreign charity or a non-charitable organization is not a taxable distribution, so long as the distribution is for a charitable purpose and the sponsoring organization exercises expenditure responsibility.

3. Excise Tax on Prohibited Benefits

Under the Act, an excise tax will be imposed on any donor, donor advisor or family member or 35-percent controlled entity[7] of a donor or donor advisor who recommends a distribution from a donor advised fund that results in a "more than incidental benefit" to a donor, donor advisor, or related person of a donor or donor advisor. In addition, an excise tax will be imposed on any donor, donor advisor, or related person of a donor or donor advisor who receives a more than incidental benefit as a result of the distribution. The amount of the excise tax is equal to 125% of the benefit amount.

Furthermore, any manager of the sponsoring organization who approves a distribution from a donor advised fund knowing that it would result in more than an incidental benefit to one of those

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5 Expenditure responsibility is a procedure currently followed by private foundations which enables foundations to make grants to certain organizations that are not public charities without incurring an excise tax.

6 A functionally integrated Type III supporting organization is defined as a Type III supporting organization that conducts activities relating to performing the functions of, or carrying out the purposes of, its supported organization(s) (a "Functionally Integrated Type III Supporting Organization").

7 Family members and 35-percent controlled entities are collectively referred to as "related persons" in this memorandum.

persons will be subject to an excise tax equal to 10% of the benefit amount, not to exceed $10,000 for any one distribution.

In defining "more than incidental benefit," the Joint Committee on Taxation's Technical Explanation cites to current law that permits a donor to receive an incidental benefit, such as a logo-bearing coffee mug, in return for a charitable contribution without being required to reduce the deductible amount of the contribution.[8] Therefore, the determination of whether a more than incidental benefit has been received for purposes of this excise tax is based on the same rules used now to determine whether a more than incidental benefit has been received for purposes of a charitable contribution deduction.

The excise tax on prohibited benefits will not be imposed on a distribution from a donor advised fund if intermediate sanctions excise taxes under Code section 4958 have also been imposed on that distribution.

B. Excess Benefit Transactions Involving Donor Advised Funds

1. Automatic Excess Benefit Transactions

Under the Act, any grant, loan, compensation or other similar payment[9] from a donor advised fund to a donor, donor advisor or related person of a donor or donor advisor is treated as an automatic excess benefit transaction, subject to excise tax penalties. The entire amount of the grant, loan, compensation or other similar payment is treated as an excess benefit.[10]

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8 See STAFF OF JOINT COMM. OF TAXATION, 109TH CONG., TECHNICAL EXPLANATION OF H.R. 4, "THE PENSION PROTECTION ACT OF 2006," AS PASSED BY THE HOUSE ON JULY 28, 2006, AND AS CONSIDERED BY THE SENATE ON AUGUST 3, 2006, JCX-38-06 ("Joint Committee Report"), 350 (2006).

9 Other similar payments include expense reimbursements but not, for example, a payment made pursuant to a bona fide sale or lease of property. See Joint Committee Report at 347.

10 This is harsher than the general rule of Code section 4958, which treats as the excess benefit the amount by which the value of an economic benefit exceeds the value of the consideration received.

2. Application of Current Law

The Act extends the excess benefit rules of current law[11] to excess benefit transactions between a donor advised fund and its disqualified persons and also between a sponsoring organization and its disqualified persons. For these purposes, a disqualified person of a donor advised fund is defined as a donor, donor advisor, or related person of a donor or donor advisor. A disqualified person of a sponsoring organization is defined as an investment advisor and his or her related persons. The term "investment advisor" is defined as any person (other than an employee of the sponsoring organization) compensated by the sponsoring organization for managing the investment of, or providing investment advice with respect to, assets maintained in a donor advised fund.

3. Examples and Effective Date

The Joint Committee Report states that the payment of compensation by a sponsoring organization to a person who both is a donor to a particular donor advised fund and a service provider to the sponsoring organization generally will not give rise to an excess benefit transaction unless the payment is viewed as a payment from the donor advised fund and not from the sponsoring organization to the service provider. The Joint Committee Report also states that the same situation will not result in an excess benefit transaction unless the service provider is a disqualified person of the sponsoring organization (i.e., by reason of serving on the sponsoring organization's governing board).[12] The Joint Committee Report provides the following example:

> For example, if a sponsoring organization pays an amount as part of a service contract to a service provider (a bank, for example) who also is a donor to a donor advised fund of the sponsoring organization, and such amounts reasonably are charged uniformly in whole or in part as routine fees to all of the sponsoring organization's donor advised funds, the transaction generally is considered to be between the sponsoring organization and the service provider in such service provider's capacity as a service provider. The transaction is not considered to be a transaction between a donor advised fund and the service provider even though an amount paid under the contract was charged to a donor advised fund. . . .[13]

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[11] See Code section 4958 and the underlying Treasury Regulations. A copy of our February 4, 2002 client memorandum summarizing the final Treasury Regulations issued under Code section 4958 can be found at www.simpsonthacher.com.

[12] See Joint Committee Report at 347-348.

[13] See Joint Committee Report at 348.

The application of the excess benefit transaction rules to donor advised funds and their sponsoring organizations is effective upon the date of enactment.

C. Excess Business Holdings in Donor Advised Funds

The Act applies the private foundation excess business holdings rules of current law[14] to donor advised funds. Under those rules, a donor advised fund may own the stock and securities of a business enterprise only up to a permitted level, which in the case of a corporation is generally 20% of the voting stock less the amount of voting stock owned by "disqualified persons" of the donor advised fund.[15] If an entity derives at least 95 percent of its gross income from passive sources, e.g., dividends and capital gains, it will not be a "business enterprise" for purposes of this provision and the ownership limitations will not apply.

In applying the excess business holdings rules to donor advised funds, the term "disqualified person" is defined as a donor, donor advisor and any related person of a donor or donor advisor.

A donor advised fund will generally have five years to dispose of any excess business holdings received by gift or bequest (rather than acquired by purchase). The rules that apply to donor advised funds that already hold excess business holdings in a business enterprise on the date of enactment are complex. These rules generally provide the donor advised fund with a transitional period of up to twenty years to dispose of any excess holdings in the business enterprise.

The excess business holdings rules will not apply to assets held by a sponsoring organization in its own investment portfolio or in a field-of-interest or designated fund (i.e., assets held outside of a donor advised fund).

The application of the excess business holdings rules to donor advised funds will be effective for taxable years beginning after the date of enactment.

D. Special Substantiation and Deductibility Rules for Contributions to Sponsoring Organizations of Donor Advised Funds

The Act permits a charitable deduction for income-tax, gift-tax or estate-tax purposes for contributions made to a donor advised fund only if the donor obtains a written acknowledgment from the sponsoring organization stating that it has exclusive legal control over the assets contributed to the donor advised fund. The donor must obtain this written acknowledgment on or before the earlier of (i) the date on which the donor files a return for the taxable year in which the contribution was made; or (ii) the due date (including extensions) for filing the return.

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14 See Code section 4943.

15 Similar rules apply to ownership of other business interests.

In addition, the Act denies a charitable deduction for contributions made to a donor advised fund sponsored by certain Type III supporting organizations.

These provisions apply to contributions made 180 days after the date of enactment.

E. Reporting and Disclosure Relating to Donor Advised Funds

1. Reporting on Annual Information Return

The Act requires a sponsoring organization of donor advised funds to report on its annual information return the total number of donor advised funds held, the aggregate value of assets held in those funds, and the aggregate contributions to and grants made from those funds.

The new reporting requirements apply to annual information returns filed by sponsoring organizations for taxable years ending after the date of enactment.

2. Disclosure on Exemption Applications

The Act requires that a sponsoring organization of donor advised funds applying for recognition of tax exemption disclose on its application that the organization maintains or intends to maintain donor advised funds and describe the manner in which the organization plans to operate those donor advised funds.

The new disclosure provisions apply to sponsoring organizations of donor advised funds applying for tax-exempt status after the date of enactment.

F. Treasury Department Study on Donor Advised Funds

The Act directs the Treasury Department to complete a study on the organization and operation of donor advised funds within one year after the date of enactment.

PROVISIONS REGARDING SUPPORTING ORGANIZATIONS

A. Provisions Applicable to All Types of Supporting Organizations

1. Definition of Supporting Organization

Current Treasury Regulations distinguish among three types of supporting organizations. The Act amends the Code to clarify this distinction for the first time.

Under the Act, a supporting organization is defined as a domestic or foreign organization described in Code section 501(c)(3) that (A) is organized, and at all times operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of, one or more specified supported organizations described in Code section 509(a)(1) or Code section 509(a)(2) ("supported

organizations"), (B) is (i) operated, supervised, or controlled by one or more supported organizations (Type I), (ii) supervised or controlled in connection with one or more supported organizations (Type II), or (iii) operated in connection with one or more supported organizations (Type III), and (C) is not controlled directly or indirectly by one or more disqualified persons (as defined in Code section 4946) other than foundation managers and one or more supported organizations.[16] The revised definition of a supporting organization is effective upon the date of enactment.

2. Excess Benefit Transactions Involving Supporting Organizations

a. Automatic Excess Benefit Transactions

Under the Act, any grant, loan, compensation or other similar payment[17] from a supporting organization to a substantial contributor of the supporting organization, a related person of the substantial contributor, or a 35-percent controlled entity of any of the substantial contributor's family members is treated as an automatic excess benefit transaction, subject to excise tax penalties. The entire amount of the grant, loan, compensation or other similar payment is treated as an excess benefit.[18]

In addition, any loan from a supporting organization to a disqualified person of the supporting organization is treated as an automatic excess benefit transaction, subject to excise tax penalties. The entire amount of the loan is treated as an excess benefit. For this purpose, the Act uses the definition of disqualified person found in the excess benefit rules of current law.[19] However, the Act specifically excludes from the definition public charities other than supporting organizations.

These provisions are effective for transactions occurring after July 25, 2006.

b. Definition of a Substantial Contributor

A substantial contributor to a supporting organization is a person who contributes or bequeaths an aggregate amount of more than $5,000 to the supporting organization, so long as the contribution or bequest is more than two percent of the total contributions and bequests received by the organization during the taxable year in which the applicable contribution or bequest is made. A substantial contributor does not include a public charity (other than a supporting organization) but

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16 The definition of a supporting organization is found in Code section 509(a)(3).

17 Other similar payments include expense reimbursements but not, for example, a payment made pursuant to a bona fide sale or lease of property. See Joint Committee Report at 358.

18 See note 13 above.

19 See Code section 4958(f)(1).

does include the creator of a supporting organization that is organized as a trust. Rules similar to those used for determining whether a donor is a substantial contributor to a private foundation apply in determining whether a donor is a substantial contributor to a supporting organization.[20]

This provision is effective for transactions occurring after July 25, 2006.

c. Definition of a Disqualified Person

The Act amends current law to provide that a person who is disqualified as to the supporting organization will also be treated as a disqualified person of the supported organization. This provision is effective for transactions occurring after the date of enactment.

3. Disclosure Requirements

The Act amends current law to require all supporting organizations, regardless of their annual gross receipts, to file an annual information return (i.e., IRS Form 990). In addition, on its IRS Form 990, a supporting organization must (i) indicate whether it is a Type I, Type II or Type III supporting organization; (ii) identify its supported organizations; and (iii) certify that it is not controlled directly or indirectly by disqualified persons (other than foundation managers and supported organizations). The disclosure requirements are effective for IRS Forms 990 filed by supporting organizations for taxable years ending after the date of enactment.

B. Provisions Applicable to Type III Supporting Organizations

In addition to provisions that apply to all supporting organizations, the Act includes certain provisions that, with one limited exception, apply only to Type III supporting organizations.

1. Annual Minimum Distribution Requirement

The Act directs the Secretary of the Treasury to issue new regulations setting out minimum distribution requirements for Type III supporting organizations other than Functionally Integrated Type III Supporting Organizations.[21] The new Treasury Regulations will require Type III supporting organizations to distribute a percentage of either income or assets to the public charities they support.

2. Prohibition on Foreign Supported Organizations

After the date of enactment, a Type III supporting organization may not support an organization that is not organized in the United States (these supporting organizations are sometimes referred to

[20] These rules are found in Code sections 507(d)(2)(B) and 507(d)(2)(C).

[21] See note 6 above for the definition of Functionally Integrated Type III Supporting Organizations.

as "friends of" organizations). This provision takes effect with respect to existing "friends of" organizations on the first day of the organization's third taxable year beginning after the date of enactment. The effect of this provision will be to require these organizations to apply to the IRS for reclassification as publicly supported charities.

3. Excess Business Holdings in Supporting Organizations

The Act applies the private foundation excess business holdings rules of current law[22] to Type III supporting organizations (other than Functionally Integrated Type III Supporting Organizations) and to certain Type II supporting organizations. Specifically, the excess business holdings rules will apply to a Type II supporting organization that accepts a gift or contribution from a person (i) who controls, directly or indirectly, either alone or together with one or more related persons, the governing body of a supported organization or (ii) who is a related person of an individual described in clause (i) (such person, a "Controlling Donor"). A public charity other than a supporting organization will not be considered a Controlling Donor.

Under those rules, the affected supporting organizations may own the stock and securities of a business enterprise only up to a permitted level, which in the case of a corporation is generally 20% of the voting stock less the amount of voting stock owned by "disqualified persons" of the supporting organization.[23]

In applying the excess business holdings rules to the affected supporting organizations, the Act uses the definition of disqualified person found in the excess benefit rules of current law.[24] The Act then expands the definition to also include: (i) a substantial contributor with respect to the supporting organization; (ii) a related person to the substantial contributor; (iii) a 35-percent controlled entity of any of the substantial contributor's family members; (iv) an organization that is effectively controlled by the same person(s) who control the supporting organization; and (v) an organization substantially all of the contributions to which were made by a substantial contributor of the supporting organization, one of his or her family members, a manager of the supporting organization or an owner of more than 20% of the beneficial interest of an entity that is a substantial contributor to the supporting organization.

The Secretary of the Treasury has the authority not to impose the excess business holdings rules on a supporting organization if the organization establishes to the Secretary's satisfaction that its excess holdings are consistent with the purpose or function constituting the basis of the supporting organization's exempt status.

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22 See Code section 4943.

23 See note 19 above.

24 See Code Section 4958(f)(1).

The affected supporting organizations are subject to the rules regarding disposal of excess business holdings received by gift or bequest and the disposal of excess holdings already held on the date of enactment.[25]

The application of the excess business holdings rules to the affected supporting organizations will be effective for taxable years beginning after the date of enactment.

4. Responsiveness Test

For each taxable year beginning after the date of enactment, a Type III supporting organization must provide to each of its supported organizations any information required by the Secretary of the Treasury to ensure that the supporting organization is responsive to the needs or demands of the supported organization. The Joint Committee Report states that a failure to provide this information will be a factor in determining whether the Type III supporting organization meets the "responsiveness test" of Treas. Reg. § 1.509(a)-4(i)(1). The Joint Committee Report further states that a Type III supporting organization could satisfy this requirement, for example, by providing to the supported organization a copy of the supporting organization's governing documents and any changes, the supporting organization's IRS Form 990 and Form 990-T, if applicable, and the supporting organization's annual report.[26]

The Act also applies the revised responsiveness test to Type III supporting organizations that are organized as charitable trusts under State law ("Type III Trusts"). The fact that a supported organization is a beneficiary of a Type III Trust and has the power to enforce the Type III Trust and compel an accounting will not, after the date of enactment of the Act, be sufficient for the Type III Trust to meet the responsiveness test. This provision takes effect for existing Type III Trusts on the one-year anniversary of the date of enactment.

C. Miscellaneous

1. Provisions Applicable to Type I and Type III Supporting Organizations

The Act provides that an organization will fail to qualify as a Type I or Type III supporting organization if it accepts a contribution from a Controlling Donor.[27] In this case, the organization will be subject to the private foundation rules. This provision is effective on the date of enactment of the Act.

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[25] See Provisions Regarding Donor Advised Funds, Section C.

[26] See Joint Committee Report at 362.

[27] See Provisions Regarding Supporting Organizations, Section B.3 above for the definition of "Controlling Donor."

2. Grants by Private Non-Operating Foundations to Supporting Organizations

The Act provides that a private non-operating foundation may not count as a qualifying distribution[28] amounts paid to certain supporting organizations. First, a private non-operating foundation may not count as a qualifying distribution amounts paid to a Type III supporting organization unless the recipient is a Functionally Integrated Type III Supporting Organizations. Second, a private non-operating foundation may not count as a qualifying distribution amounts paid to any other supporting organization if a disqualified person with respect to the foundation directly or indirectly controls the supporting organization or a supported organization of the supporting organization. These non-qualifying distributions will be treated as taxable expenditures, unless the private foundation exercises expenditure responsibility.[29] These provisions are effective for distributions and expenditures made after the date of enactment.

D. Treasury Department Study on Supporting Organizations

The Act directs the Treasury Department to complete a study on the organization and operation of supporting organizations within one year after the date of enactment.

OTHER PROVISIONS OF INTEREST

A. Modification of Tax Treatment of Certain Payments to Controlling Exempt Organizations

Under current law, payments of rent, royalties, annuities, and interest received by a tax-exempt organization from a controlled entity are treated as unrelated business income, but only to the extent the payments reduce the net unrelated income (or increase any net unrelated loss) of the controlled entity. The Act helpfully amends this provision so that these kinds of payments are included in the controlling organization's unrelated business income only to the extent that the payments exceed fair market value (as determined in accordance with Code section 482), and the excess reduces the net unrelated income of the controlled entity. In addition to including the excess amount in its unrelated business income, the controlling organization will be subject to a penalty tax of 20% of the larger of (i) the excess amount determined without regard to any amendment or supplement to a return or tax, or (ii) the excess amount determined with regard to all amendments and supplements. The provision applies only to payments made pursuant to a binding written contract in effect on the date of enactment (or renewal of that contract on substantially similar terms); further study is expected before the provision is expanded. The provision applies to payments received or accrued after December 31, 2005 and expires as of December 31, 2007.

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[28] The definition of qualifying distribution is found in Code section 4942.

[29] The definition of taxable expenditure is found in Code section 4945.

Each controlling organization is also required to include on its annual information return information regarding payments to and from its controlled entities. This provision is effective for returns the due date (determined without regard to extensions) of which is after the date of enactment.

The Act directs the Secretary of the Treasury to submit to Congress no later than January 1, 2009 a report on the IRS's effectiveness in administering these provisions and on the extent to which payments by controlled entities meet the requirements of Code section 482.

This provision is effective on the date of enactment.

B. Increase in Excise Taxes Related to Excess Benefit, Self-Dealing and Other Transactions

The Act doubles the amount of penalty excise taxes applicable to certain acts of private foundations and their organization managers and disqualified persons. Those excise taxes include the taxes on self-dealing, the failure to distribute income, excess business holdings, and investments which jeopardize charitable purposes. The Act also doubles the maximum amount payable by organization managers of public charities and social welfare organizations who knowingly participate in excess benefit transactions.

This provision is effective for taxable years beginning after the date of enactment.

C. Expansion of the Base of the Tax on Private Foundation Net Investment Income

The Act amends the definition of gross investment income to include income from "sources similar" to those enumerated in the Code, and therefore expands the base on which the net investment income tax is calculated. This amendment is in response to the Zemurray case,[30] which held that the definition included only the items enumerated in Code section 4940. In addition, the Act permits a private foundation to exclude, in calculating its net investment income, capital gains and losses with respect to dispositions of property used for exempt purposes for at least one year if the property is exchanged for like-kind property in accordance with rules similar to those used in Code section 1031 like-kind exchanges. This exclusion is dependent upon the adoption of regulations to implement it.

This provision is effective for taxable years beginning after the date of enactment.

[30] Zemurray Foundation v. United States, 53. A.F.T.R. 2d (RIA) 842 (E.D. La. 1983). See Joint Committee Report at 322-3.

D. Limit on Charitable Deduction for Contributions of Clothing and Household Items

The Act specifies that deductions will only be allowed for charitable contributions of clothing and household items[31] in good used condition or better.[32] In addition, the Secretary of the Treasury may by regulation deny a deduction for any item with minimal monetary value. These rules do not apply to any contribution of a single item for which a deduction of more than $500 is claimed, provided that the donor files a qualified appraisal of the item with the donor's tax return.

This provision is effective for contributions made in taxable years beginning after the date of enactment.

E. Modification of Recordkeeping and Substantiation Requirements for Monetary Charitable Contributions

The Act adds a new requirement that, in order to claim a deduction for a monetary contribution, regardless of the amount, a donor must maintain a bank record or a written communication from the recipient organization showing the name of the recipient organization, the date of the contribution, and the amount of the contribution. Current law requires that only monetary contributions of $250 or more need to be substantiated in this manner.

This provision is effective for contributions made in taxable years beginning after the date of enactment.

F. Contributions of Fractional Interests in Tangible Personal Property

The Act contains significant changes with respect to charitable contributions of fractional interests in tangible personal property. Gifts of artwork to museums are commonly structured as fractional gifts, whereby the donor and the museum each possess the artwork for a period of time during the year. The Act provides for the recapture of a charitable contribution deduction if the donor does not subsequently contribute his or her entire interest in the property within ten years of the date of the initial gift (or the date of his or her death, if earlier). In addition, the recipient charitable organization must have "significant physical possession" of the property and use it in a manner related to its exempt purposes. Furthermore, when the remaining interest in the property is donated, the value of the deduction will be based on the lesser of the fair market value at that time or the fair market value when the initial fractional interest was contributed.

This provision is effective with respect to gifts and bequests made after the date of enactment.

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[31] The term "household items" includes furniture, furnishings, electronics, appliances and linens but does not include (i) paintings, antiques, and other objects of art; (ii) jewelry and gems; and (iii) collections.

[32] The Act does not define "good used condition."

G. Recapture of Tax Benefit on Property Not Used for an Exempt Use

Under current law, donors are generally allowed to deduct charitable contributions of tangible personal property at fair market value, provided that the recipient charitable organization puts the property to a use related to its exempt purposes. The Act includes a provision to recover the tax benefit a donor receives for claiming a fair market value deduction with respect to property not subsequently put to a related use. The provision applies if the recipient organization disposes of the property within three years of the date of the contribution. An exception to the recapture provision applies if the recipient charitable organization certifies that the property was put to a related use or that the intended related use became impossible to implement. A $10,000 penalty applies to a person who identifies applicable property as having a related use knowing it is not intended for a related use.

These provisions are effective for contributions made and returns filed after September 1, 2006, and with respect to the penalty, for identifications made after the date of enactment.

H. Notification Requirement for Exempt Organizations Not Currently Required to File IRS Form 990

The Act adds a new requirement that tax-exempt organizations (other than private foundations) with gross receipts of less than $25,000 must file electronically an annual notice containing basic contact and financial information. An organization that fails to file an annual return or notice for three consecutive years may have its exempt status revoked; however, a process will exist for reinstatement of exempt status.

This provision is effective for notices and returns with respect to annual periods beginning after 2006.

I. Disclosure of Information Regarding Charitable Organizations to State Officials

The Act expands upon the information that the Secretary of the Treasury may disclose to appropriate State officials. Disclosure or inspection is only permitted for the purpose of the administration of State laws regulating 501(c)(3) organizations, or to facilitate the resolution of federal and State issues relating to the tax-exempt status of an organization.

This provision is effective on the date of enactment but does not apply to requests made before that date.

J. Public Disclosure of IRS Forms 990-T Filed by Charitable Organizations

The Act provides that unrelated business income tax returns (i.e., on IRS Form 990-T) of Code section 501(c)(3) organizations must be available for public disclosure and inspection in the same manner as annual information returns on IRS Forms 990.

This provision is effective for returns filed after the date of enactment.

K. Provisions Relating to Substantial and Gross Overstatements of Valuations

The Act reduces the thresholds for imposing accuracy-related penalties on a donor for valuation misstatements on contributed property for which an appraisal is required, and eliminates the reasonable cause exception for gross valuation misstatements. This provision is effective for returns filed after the date of enactment.

In addition, the Act establishes a civil penalty on any person who prepares an appraisal knowing that it is to be used in connection with a return or a claim of refund if the appraisal results in a substantial or gross valuation misstatement. The Act also provides for greater oversight of appraisers by requiring appraisers to meet new qualifications. The appraisal provisions are effective for appraisals prepared for returns and submissions filed after the date of enactment.

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The Act contains the most significant changes for charities since the 1969 reforms. This memorandum is only a summary of key provisions of interest to charitable organizations and their donors. If you have any questions about these or any other provisions of the Act, please do not hesitate to contact Victoria B. Bjorklund (212-455-2875; vbjorklund@stblaw.com); David A. Shevlin (212-455-3682; dshevlin@stblaw.com); Jennifer I. Reynoso (212-455-2287; jreynoso@stblaw.com); Jennifer L. Franklin (212-455-3597; jfranklin@stblaw.com); Marion Ringel (212-455-2941; mringel@stblaw.com) or Ingrid Seradarian (212-455-3145; iseradarian@stblaw.com).