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PENSION PROTECTION ACT OF 2006

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PPA 2006 Tax Alert - Exempt Organizations, Beware!

On Aug. 17, 2006, President Bush signed into law the Pension Protection Act of 2006 (PPA). As the title suggests, its primary focus is pension plan reform. But buried in the new law are some significant changes affecting exempt organizations. Under the PPA, both exempt healthcare organizations and non-profit organizations face increased scrutiny and reporting requirements.

Here are some exempt organization's expanded disclosure requirements and penalties to be aware of:

- Form 990-T, *Exempt Organization Business Income Tax Return*, in which exempt organizations report their unrelated business income, is subject to public inspection similar to Form 990. Fortunately, the provision related to accuracy certification of the 990-T by an organization's independent auditor did not make it into the PPA.

- PPA promotes better governance and transparency by enabling greater information sharing between the IRS and state officials who enforce the state's charity regulations (e.g. notice of refusal to recognize exempt status, notice of proposed deficiencies).

- PPA doubled the maximum intermediate sanctions excise tax from $10,000 to $20,000 on "excess benefit transactions" with "disqualified persons" for organization managers who knowingly approve an excess benefit transaction.

- PPA defines *donor advised funds* and places restrictions on their use subject to penalties. PPA's goal is to limit the amount of influence donors have with such funds and to make such funds more accountable.

- If your organization has a tiered corporate structure, the parent organization may be classified as a supporting organization. PPA's changes include:

    - Statutory definition of Types I, II and III supporting organizations.
    - A disqualified person in the supporting organization is now also treated as a disqualified person in the supported organization.
    - An expanded definition of excess benefit transactions to include certain transactions *as per se automatic excess benefit transactions* (e.g. grants, loans and compensation paid to substantial contributors) even if such transactions are completed at fair market value.
    - Increased disclosures required on Form 990.

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- Organizations that are excused from filing Form 990 because their gross receipts are below the filing threshold must now electronically file to the IRS annually basic entity information such as basic contact and officer information. Entities that fail to do so for three consecutive years will have their tax-exempt status revoked.

- Beginning in 2007, if an exempt organization is required to file a Form 990, failure to do so for three consecutive years will result in revocation of exempt status.

- PPA imposes stricter penalties for over and under valuations of property and imposes new standards on appraisers and appraisals for both income tax and estate tax purposes.

The Good News:

- PPA allows IRA owners over 70.5 years old to make direct tax free distributions of up to $100,000 to charitable organizations for 2006 and 2007.

- PPA includes improved basis reduction rules for S corporation shareholders whose S corporation makes charitable gifts of appreciated property for 2006 and 2007.

- Related party rent or interest is not taxable as UBIT under the controlled entities rule for 2006 and 2007 if it meets the Section 482 transfer pricing fair market value rule. The relief is limited to binding contracts in place as of Aug. 17, 2006. Congress intends to evaluate this trial provision over the next two years and possibly make this change permanent.

- Tax exemptions are available for Red Cross and other qualified blood collection organizations from various excise taxes including special fuels tax, communications excise tax and retail excise tax on heavy trucks and trailers.

- PPA raises the charitable deduction limit from 30% to 50% for contributions of certain qualified conservation easements.

Changes affecting your donors:

- PPA provides for tax deduction recapture for contributions of tangible personal property with a fair market value in excess of $5,000 if the exempt organization does not use the property for a tax exempt purpose. Additional rules, including reporting requirements, apply if the charity disposes of such property within three years of receipt.

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- If your organization maintains a thrift shop:
  - No charitable deduction is allowed for donations of used clothing or household items unless they are in good used condition.
  - A qualified appraisal is required for any single item worth more than $500.

- Donor recordkeeping requirements are now more onerous. Beginning in 2006, cash or other monetary donations cannot be deducted without substantiation such as a cancelled check, receipt or written acknowledgement from the charity. The old law only required written acknowledgement if the donation exceeded $250.

- Donations of fractional interests in tangible personal property are subject to recapture if the donor fails to contribute all of the remaining interest in the property before the earlier of 10 years from the initial contribution or the donor's death.

Other Developments beyond PPA:

- Stipends paid to medical residents exempt from FICA - Stay tuned for the outcome of United States v. University Hospitals, Inc. in which stipends paid to medical residents are subject to FICA. The hospital treats the payments as scholarships or payments to students which are exempt from FICA. However, the IRS believes it is subject to FICA as a matter of law.

- Independent contractor test simplified -The IRS finally adopted a simplified method for determining whether a worker is an employee or independent contractor. The new test replaces the old 20-factor test and now bases its test on three areas: behavioral control, financial control and the relationship between the parties. The revised test is found in the 2006 edition of IRS Publication 15-A.

We hope you have found this introduction to the PPA informative. If you would like further details about the PPA, please call Nolan Newman or Ann Imus at 206-284-1383 at your earliest convenience. You can also find more information about the PPA at http://tax.cchgroup.com/Legislation/default

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