

LEGAL ALERT

February 15, 2007

THE IMPACT OF THE PENSION PROTECTION ACT OF 2006 ON NONPROFIT ORGANIZATIONS

The Act impact all nonprofit organizations, no matter the size.

By Scott D. Harvey, Attorney

The Pension Protection Act of 2006 (the “Act”), which was signed into law on August 17, 2006, contains several significant charitable reforms that impact nonprofit organizations organized under Section 501(c)(3) of the Internal Revenue Code. These provisions, while significant, may mark only the beginning of congressional reforms that will impact such organizations. While the Act contains certain charitable giving incentives and reforms applicable to donors, this legal alert focuses on the major charitable reforms contained in the Act as they apply to nonprofit organizations.

The Act contains certain charitable reforms that impact all nonprofit organizations, including requiring substantiation of contributions to donors and increased penalties for failure to file required information returns with the IRS.

Accordingly, effective for contributions made in tax years beginning after August 17, 2006, donors who itemize deductions must have a bank record or written communication from the nonprofit organization to claim a deduction for a monetary contribution, regardless of the amount. The bank record or receipt from the charity must indicate the name of the organization, the date of the contribution, and the amount of the contribution.

In addition, for tax years after 2006, any nonprofit organization that does not currently have to file an annual information return (Form 990) because their gross annual receipts are less than \$25,000 will now have to file an annual information return with the IRS. The IRS is in the process of creating the new return form, which will have to be filed electronically by the organization. The failure to file this return for three consecutive years will result in the revocation of the charitable organization’s tax exempt status. Significantly, this revocation would also apply to any charitable organization that is required to file Form 990 (because its gross receipts are in excess of \$25,000), but fails to do so for three consecutive years.

Finally, for returns filed after August 17, 2006, charitable organizations that file an Unrelated Business Income Tax

(“UBIT”) Return (Form 990-T) are now required to make those returns available to the public on the same basis as their Form 990 returns.

Perhaps the most significant aspect of the Act as it relates to nonprofit organizations is the provisions that impact “donor advised funds” (“DAFs”) and “supporting organizations”. These provisions place significant burdens and restrictions upon DAFs and “supporting organizations”.

DAFs are those funds that are separately identified by reference to contributions of a donor that it is owned and controlled by what is known as a “sponsoring organization” (e.g., a community foundation) of which the donor has advisory privileges as to the distribution or investments of amounts held in that fund.

The Act now provides that certain distributions from DAFs are subject to tax. For transactions occurring after August 17, 2006, distributions from a DAF to an individual, to certain supporting organizations or private foundations, or to a distribution for purposes that are not “charitable” are subject to an excise tax equal to 25% of the amount of the distribution.

The Act also provides that any grant, loan, compensation, or other payment to a donor, an advisor of the donor, or a related party is treated as an “excess benefit” and a penalty tax of 25% is imposed and the amount paid must be repaid and may not be held in the DAF.

Furthermore, sponsoring organizations must report annually on their Form 990 return the total number of DAFs owned, the aggregate value of assets held in those funds, and the aggregate contributions to, and grants made, from those funds during the year.

The Act impacts donors to DAFs as well. Donors will now only be able to receive a tax deduction for a gift to a DAF provided they have a contemporaneously written acknowledgement from the sponsoring organization

stipulating that it has exclusive control over the assets contributed. Furthermore, no deductions are permitted for gifts to DAFs that are held by certain supporting organizations. Finally, and perhaps most significant, the Treasury Department will undertake a study of DAFs to determine whether the deductibility of contributions to DAFs are appropriate. This study could lead to the prohibition of deductions for future contributions to DAFs. While unlikely, it could also lead to a retroactive disqualification of deductions for contributions to DAFs made on or after the date of the Act.

The Act also contains various provisions that impact “supporting organizations”. “Supporting organizations” are those charitable organizations that gain their public charity status by virtue of their status support for other organizations; usually public charities. “Supporting organizations” are “typed” based upon their relationship with the “supported” organizations. Certain of the Act’s provisions are applicable to all supporting organizations, while some are only applicable to “Type I” or “Type III” supporting organizations.

The Act prohibits *any* supporting organization from receiving a “charitable IRA rollover” distribution (a tax-free distribution directly from an IRA account, which is one of the charitable giving incentives created by the Act). The Act also prohibits *any* supporting organization from making any grant, loan, compensation or other payment to a “substantial contributor”, a member of the substantial contributor’s

family, or an entity that is 35% or more controlled by a contributor or related family member. Finally, for tax returns filed after August 17, 2006, the Act provides that *all* supporting organizations are required to include in their Form 990 return a list of all of its “supported” organizations, the type of supporting organization each is, and certification that the organization is not controlled, directly or indirectly, by one or more disqualified persons.

The Act also provides that a “Type I” or a “Type III” supporting organization may lose its public charity status if it accepts any gift or contribution from a person (together with related parties) who directly or indirectly control the supported organization. Finally, the Act contains certain restrictions that apply specifically to “Type III” supporting organizations including minimum payout requirements, demonstration of responsiveness to their “supported” organizations, and a prohibition on foreign “supported” organizations.

If you have any questions about how the Pension Protection Act affects your organization, or would like more information about the Act, please do not hesitate to contact a member of Smith Haughey Rice & Roegge’s Nonprofit Organization Law Team.

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