

The Pension Protection Act of 2006

Your exciting new opportunity

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These are important too (if not quite as interesting)

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Pepperoncini & Capers

A startling provision

Your Feedback

I'm interested in your opinion



The Pension Protection Act of 2006

The just-enacted Pension Protection Act has some important provisions for charitable giving that I think you should know about.

Please recognize that my analysis is based on my reading of the Act without the benefit of IRS rulings, tax court decisions or other official guidance that have yet to come.

The House and Senate passed this Act in identical versions and President Bush signed it last week.

You should now talk to your donors about the most significant provision: gifts from Individual Retirement Accounts, under circumstances described below. And acquaint yourself with other PPA provisions.

There are other meaningful, if more arcane, provisions that really deserve your attention because they can cause big problems for your office, your organization and your donors if not adhered to. These concern **insurance “gifts,” qualified appraisals** and **the related use rule** .

You can access the **Pension Protection Act** online and download a pdf of the Joint Committee on Taxation **Technical Explanation**. Both are excerpted or referred to below.

Let's take a look.

Old Law-Giving From IRAs

“A donor can make qualified charitable distributions from eligible IRAs up to \$100,000 per tax year.”

In simplest and most relevant terms, pre-Pension Protection Act law boiled down to what has become quite familiar to fundraisers: a charitable gift that originated from your donor's Individual Retirement Account had to be treated as any other IRA distribution, mandatory or otherwise, and irrespective of age. Your donor reported the distribution as income, presumably in the same year they would report their charitable deduction to your institution. Thus, your donor had to pay additional income tax and the distribution benefiting your non-profit could have put them in a higher marginal tax bracket.

We all know from personal experience that the tax payment on the additional income deterred most donors from giving from their often over-funded IRA. For some reason, the potentially offsetting charitable deduction was never, in my experience, motivating.

New Law-Giving From IRAs

The Act permits charitable gifts that originate from an IRA, without your donor having to report the IRA distribution as income.

Here are the requirements for a "qualified charitable distribution" under the Pension Protection Act:

1. Your donor has reached at least 70 1/2 years of age
2. Their IRA custodian makes a distribution directly to your organization (supporting organizations and donor advised funds are not included)
3. The gift comes from any type of IRA, including traditional or Roth, except SEP (simplified employee pension) and SRA (simple retirement account) IRAs
4. The entire distribution would qualify as a charitable income tax deduction. (Your donor does not receive a deduction; see below.)
5. The distribution is made during the remainder of 2006 or in 2007.

A donor can make qualified charitable distributions from eligible IRAs up to \$100,000 per tax year. Importantly, that limit is per donor, not per account.

A distribution into a charitable trust, or to create a charitable trust or Charitable Gift Annuity, will not be a qualified charitable distribution.

Regarding number 4 above, your donor's gift (the distribution to your organization) is excluded from their income only if the entire gift amount will qualify as a charitable income tax deduction. (Your donor does not receive a deduction for their gift to you, because their deduction was taken when they contributed to their IRA plan.) The following examples are common.

- A. The purchase of a seat or table at your annual gala. Your donor receives value in exchange for the price they pay and (I very much hope) you inform ticket purchasers how much of their ticket price is deductible (the price they paid minus the value they will receive). Thus, the entire price cannot be claimed as an income tax charitable deduction.

If your donor buys a seat or table by making a distribution to you from an eligible retirement account, the distribution will not be a qualified charitable distribution and all of the distribution will be included in their gross income for the year.

- B. Likewise, gifts made to colleges and universities where your donor earns the right to purchase tickets to your athletic events are only 80% deductible under pre-Pension Protection Act law. You would not encourage these donors to make their gifts from an IRA because the entire gift amount will be included in their income.
- C. Finally, if yours is a communist controlled organization then you know that deductions are disallowed for gifts to your institution. Thus, gifts to you cannot qualify for the Pension Protection Act.

This rule that requires the entire gift to qualify for charitable income tax deductibility is applied without regard to the 50% and 30% deduction limitations that apply to gifts to your non-profit. If the applicable limitation would have kept the gift from being

entirely deductible, that alone will not prevent the PPA IRA gift from being excluded from your donor's income as a qualified charitable deduction.

The Act does not specifically refer to ignoring the 3% overall limitation on itemized deductions above this year's \$150,500 threshold. That limitation can also very likely be ignored, as suggested by the Technical Explanation and in keeping with the spirit of the Act.

You never want to give your donors tax advice. That is the prerogative of their professional advisors and those advisors will need to make determinations in the following areas:

- i. A gift will qualify under the Act only to the extent the distribution would have been includable in your donor's gross income had it not been a PPA distribution. Any amount not includable in gross income will not qualify. (This rule will make gifts from Roth IRAs rare.)
- ii. There are rules for determining how to treat amounts that would not be includable in gross income had they been a non-PPA distribution (e.g. most distributions from Roth IRAs or from traditional IRAs that have amounts in them that were not deducted when contributed to the IRA).
- iii. Finally, the PPA gift is taken into account for satisfying required minimum distribution rules the same as if it had been a non-PPA distribution. The advisor will want to ensure compliance with the RMD rules.

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IRA Gift Implications For Your Fundraising

The Pension Protection Act of 2006 can benefit your annual, major and Planned Giving efforts. Unlike the Katrina Emergency Tax Relief Act of 2005, PPA benefits encompass donors at every level. A \$50 donor can use the Act (if their IRA custodian permits distributions of that size). With the upper limit at \$100,000 per donor per year, we're talking about a lot of potential gifts.

"You might consider a campaign built around IRA giving."

You might consider a campaign built around IRA giving. Encourage gifts from IRAs at events and meetings, including board meetings; use personalized mail; write or purchase the inevitable-to-be-published materials on how the Act works; train staff and use all your communications outlets, all with an eye toward getting word to your constituents.

I firmly believe KETRA was not as lucrative as it could have been because there was delay in getting the word out to prospects. The delay was due to misunderstanding and disbelief and it hurt non-profits. I have an article on that subject in the January-February [issue](#). Let's not repeat those unfortunate and costly missteps.

You shouldn't hesitate to inform your suspects, prospects and donors who are of the appropriate age how the Pension Protection Act can help them help your organization.

Timing is important. Urge your donors not to wait until near year end (from mid-December on) to inform their IRA custodian or administrator to make the charitable distribution. Custodians will probably not consider these distributions a high priority (I think we can take a lesson from brokers who are asked to make DTC transfers). If the transfer doesn't hit your organization's account before January 1 then the distribution will be included in your donor's income in that year and tax will have to be paid on it.

Also recognize that IRA custodians will not take direction, or prodding, from you. You will have to urge your donor to stay on top of their requested distribution until it reaches your account. Please encourage your donors not to wait until the last minute so as to give their plan custodian plenty of time to act.

Annual Giving/Annual Appeal. As the 4th quarter approaches I know you are planning your end of year appeals. It shouldn't be too late to change your letters, and maybe even your envelopes, to include an explanation or a teaser about the chance to use an overfunded IRA to make an annual gift. You have strategies to increase gift size and participation and this

belongs among them.

Major Giving. This is an excellent opportunity to encourage donors to pay off multi-year pledges or to consider accelerating their payments into 2006 and 2007. In meetings and formal solicitations where the donor may be over 70 (let's talk like fundraisers, not lawyers and accountants) you would be wise to raise the possibility of a gift, or part of a gift, coming from the donor's IRA.

You may even have donors who have asked about making a gift from their IRA. In your relationship building and cultivation meetings with donors, have they revealed they have an IRA that has grown much bigger than they'd ever expected and could ever need? Overfunded IRAs are not restricted to the wealthy.

Many, many unassuming middle income people had put the maximum allowable into their IRA year after year, were generously matched, and enjoyed huge retirement savings growth in recent decades. Look not only to the ostensibly wealthy, but also to teachers, postal workers, other civil servants, nurses and professors. They typically have modest lifestyles, so it takes less in their IRA for them to consider it overfunded.

Look also to widows and widowers. If they inherited generously from their spouse, they may not need everything in their IRAs.

Recognize that many people do not need as much as their required minimum distribution mandates they take each year. Inform those who this may apply to, that a qualified charitable distribution counts toward their RMD. If the conversation goes further, encourage them to seek advice from their financial advisor and offer to follow up shortly, either with the advisor or donor or both.

Planned Giving. Everything said under Major Giving applies here.

Also, this is an opportunity to explain the financial advantages (for recipients) of naming your non-profit as beneficiary, or contingent beneficiary, of an IRA, and leaving other liquid assets to heirs. Remind your donor that beneficiary designations can be made in percentages, so they can leave some to individuals (if they wish to ignore the estate and income tax consequences for recipients) and even some to other non-profits, and still help your organization.

Beneficiary designations are so simply made, by completing a short form provided by the IRA administrator. Remember to share your (official) legal name and federal tax ID number with those who intend to name your institution.

For donors you are close to, or who want campaign credit for a beneficiary designation, you can discuss the testamentary contract. This enforceable agreement allows the donor to bind their estate to a certain gift at their death. I have had terrific success with this for many years, and it can bridge the gap between the revocable gift and gift or campaign recognition. Plus, it adds to net assets on a present value basis and that is satisfying to your CFO.

For additional ways that Planned Giving can help the other giving functions, see this [article](#) in the last issue.

Conclusion. The Pension Protection Act of 2006 includes this potentially significant IRA provision that comes with many technicalities. Make your donors aware early so you can maximize your organization's potential and so the entire non-profit community benefits. As prospects show interest in becoming IRA donors, never be afraid to consult an expert and refer your prospects to their advisors. You will gain long term credibility that exceeds the value of any gift, particularly one incorrectly executed.

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Other Subjects That Merit Your Attention

Life Insurance and Annuity "Gifts." Non-profits must now report to IRS their acquisition of an interest in what I call "schemes" that come in a few variations but that typically involve life insurance and commercial annuities. Here is the text of the most informative subsection defining "reportable acquisition" and "applicable insurance contract." This is excerpted from the Pension Protection Act of 2006, §6050V (you will find the Act [here](#)):

"[Y]our counsel should look much further than this article goes."

(d) Definitions- For purposes of this section--

` (1) REPORTABLE ACQUISITION- The term `reportable acquisition' means the acquisition by an applicable exempt organization of a direct or indirect interest in any applicable insurance contract in any case in which such acquisition is a part of a structured transaction involving a pool of such contracts.

` (2) APPLICABLE INSURANCE CONTRACT-

` (A) IN GENERAL- The term `applicable insurance contract' means any life insurance, annuity, or endowment contract with respect to which both an applicable exempt organization and a person other than an applicable exempt organization have directly or indirectly held an interest in the contract (whether or not at the same time).

If you believe your organization has an interest that may require it to report, your counsel should look much further than this article goes.

Qualified Appraisals. Section 6695A of the Act (which creates §6695A of the Internal Revenue Code) tightens the rules on qualified appraisals and qualified appraisers. Responsibility for complying with substantiation requirements for charitable deductions always rests with your donors, but you may want to know what it is you are asking your donor to obtain and pay for. The pre-PPA rules are found in Internal Revenue Code §170(f) (11) and the regulations in support of that section, Rev. Reg. §1.170A-13(c).

“[Y]ou may want to know what it is you are asking your donor to obtain and pay for.”

I think the Technical Explanation lays out these new provisions succinctly. (You can download the Technical Explanation [here](#). Refer to page 308, which corresponds to page 318 in the pdf.)

Qualified appraisals

The [Act] defines a qualified appraisal as an appraisal of property prepared by a qualified appraiser (as defined by the [Act]) in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Secretary.

Qualified appraisers

The [Act] defines a qualified appraiser as an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements to be determined by the IRS in regulations; (2) regularly performs appraisals for which he or she receives compensation; (3) can demonstrate verifiable education and experience in valuing the type of property for which the appraisal is being performed; (4) has not been prohibited from practicing before the IRS by the Secretary at any time during the three years preceding the conduct of the appraisal; and (5) is not excluded from being a qualified appraiser under applicable Treasury regulations.

[Bracketed] notes were added by me. Thus, the Code now has a narrower definition of a qualified appraisal, relying on generally accepted industry standards, in addition to the IRS guidance that was already in place.

For your donors, the threshold for a substantial valuation misstatement and a gross valuation misstatement have been lowered to 150% and 200%, respectively, over the amount determined to be the correct value. They had been 200% and 400%.

Related Use Rule. This is the rule that reduces your donor's charitable deduction from fair market value to cost basis for gifts of tangible personal property that are not related to your organization's charitable purpose.

“[A] monetary penalty your officers can suffer.”

The Pension Protection Act continues that penalty, and adds important new procedures that your organization must comply with and a monetary penalty your officers can suffer. Here is an excerpt from the [Technical Explanation](#), page 300, which corresponds to page 310 in the pdf:

The [Act] applies to appreciated tangible personal property that is identified by the donee organization, for

example on the Form 8283, as for a use related to the purpose or function constituting the donee's basis for tax exemption [your organization's charitable purpose or function; your mission], and for which a deduction of more than \$5,000 is claimed ("applicable property").³⁸²

Under the [Pension Protection Act], if a donee organization disposes of applicable property within three years [note this change] of the contribution of the property, the donor is subject to an adjustment of the tax benefit. If the disposition occurs in the tax year of the donor in which the contribution is made, the donor's deduction generally is basis and not fair market value.³⁸³ If the disposition occurs in a subsequent year, the donor must include as ordinary income for [their] taxable year in which the disposition occurs an amount equal to the excess (if any) of (i) the amount of the deduction previously claimed by the donor as a charitable contribution with respect to such property, over (ii) the donor's basis in such property at the time of the contribution. [This is the amount by which their basis in the property exceeds the deduction they claimed for the gift; that amount must be reported in their income in the year of the disposition.]

There is no adjustment of the tax benefit if the donee organization makes a certification to the Secretary, by written statement signed under penalties of perjury by an officer of the organization. The statement must either (1) certify that the use of the property by the donee was related to the purpose or function constituting the basis for the donee's exemption [your organization's charitable purpose or function; your mission], and describe how the property was used and how such use furthered such purpose or function; or (2) state the intended use of the property by the donee at the time of the contribution and certify that such use became impossible or infeasible to implement. The organization must furnish a copy of the certification to the donor (for example, as part of the Form 8282, a copy of which is supplied to the donor [at the time of your organization's disposition of the property]).

A penalty of \$10,000 applies to a person [that includes your organization's officer who signed the certification under penalty of perjury] that identifies applicable property as having a use that is related to a purpose or function constituting the basis for the donee's exemption knowing that it is not intended for such a use.³⁸⁴

³⁸² Present law rules continue to apply to any contribution of exempt use property for which a deduction of \$5,000 or less is claimed.

³⁸³ The disposition proceeds are regarded as relevant to a determination of fair market value.

³⁸⁴ Other present-law penalties also may apply, such as the penalty for aiding and abetting the understatement of tax liability under section 6701.

[Bracketed] notes were added by me. As you can see, these are substantial changes in procedure for your institution: expanding the disposition period to three years; adding an optional certification under penalty of perjury; and adding a \$10,000 penalty for committing perjury in the certification.

You might also take this opportunity to refresh your understanding of how Forms 8282 and 8283 are to be used and shared. There is often confusion around these forms.

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Pepperoncini & Capers

If you've read this far, you want to know the most startling and consequential change of the Pension Protection Act of 2006. Sections 1419 and 1420, respectively, eliminate the duty on "certain pepperoncini" and "certain capers" through December 31, 2009. Epicureans, rest easy.

"Epicureans, rest easy."

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Your Feedback

I am always interested in your opinion of The Martignetti Report. You can [send me a message](#) from here with your comments. Or, you can always reach me through the company [website](#)

Best regards,



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