

## TOPIC:

# THE PENSION PROTECTION ACT OF 2006: CHARITABLE GIVING AND REFORM MEASURES IMPACTING COLLEGES AND UNIVERSITIES

## INTRODUCTION:

On August 17, 2006, President Bush signed into law the [Pension Protection Act of 2006](#) (H.R. 4) ("PPA"). This legislation directly impacts colleges and universities in two principal respects: it provides charitable giving incentives and it implements a number of significant changes designed to effectuate charitable reform. Its application, however, may affect the higher education community in a number of unanticipated ways.

This NACUANOTE discusses the [Pension Protection Act of 2006](#) and its impact on higher education institutions, and offers practical guidance to counsel and administrators for addressing related issues.

## DISCUSSION:

### I. Distribution of Individual Retirement Account to Charity

Donors who reach the age of 70 ½ in 2006 or who will reach that age prior to the end of 2007 receive the greatest benefit from the [PPA](#). Under this highly anticipated provision, a donor who meets the age requirement in 2006 may distribute \$100,000 in each of 2006 and 2007 from his or her Individual Retirement Account ("IRA") to qualifying charitable organizations and is not required to include the amount distributed in gross income [\[1\]](#). Donors who reach age 70 ½ in 2007 would be able to take advantage of this provision only in 2007.

In administering this new provision and discussing it with potential donors, planned giving officers should be aware of the following potential traps:

- Qualifying charitable donations from an IRA may not be made to supporting organizations, private foundations or donor advised funds. Many colleges and universities have related foundations that are classified as supporting organizations within the meaning of [Section 509\(a\)\(3\)](#) of the Internal Revenue Code of 1986, as amended ("Code"). Special care should be taken when talking to donors so that any distribution from an IRA is made to an entity that is not a supporting organization. Many times this may require contributions to be made directly to the college or university, rather than the foundation.
- This provision does not apply to distributions from [401\(k\)](#) or [403\(b\)](#) plans, defined benefit plans, or Keogh Plans. In order for a donor to make a qualifying charitable contribution from these types of plans, he or she would be required to roll the plan assets into an IRA, if allowed under the plan rules.

- A donor may not receive goods or services in return for the contribution (for example, a foursome in a golf outing or a table at a fundraising event).
- A donor may not make a qualifying contribution to a charitable remainder trust or charitable lead trust, or in exchange for a charitable gift annuity.
- The donor must receive an acknowledgment from the charity for his or her gift, even though the contribution to the charity from the IRA must come directly from the IRA plan administrator. Some IRA administrators may not be equipped to issue a third party check to the charity with the donor's name in the reference line. Therefore, the planned giving department should work with the donor directly, so that it knows to whom to issue the acknowledgement letter.
- Planned giving departments should encourage donors who are interested in this opportunity to begin working with their plan administrators as soon as possible so that they can understand the additional rules that plan administrators may apply to these gifts. For instance, many administrators may apply minimum contribution amounts to these gifts so that they are not required to issue numerous \$1,000 checks to different charitable organizations.
- The state income tax impact resulting from a donor's qualifying charitable donation will vary significantly from state to state.

## II. Recovery of Tax Benefits on Charitable Contributions

Generally, a donor may take an income tax deduction equal to the fair market value of any tangible personal property contributed to a charity if the property will be used in furtherance of the charity's tax-exempt purposes (for example, a rare book collection given to a university library) [\[2\]](#). If the property is valued at more than \$5,000, the donor would obtain an appraisal and attach a copy of [Form 8283](#) (which the donee organization must acknowledge, but not complete) to his or her federal income tax return.

[Section 1215 of the PPA](#) now provides that the charitable deduction for contributions of tangible personal property with a value in excess of \$5,000 may be recaptured if the charity disposes of the property within three years. The recapture amount is equal to the excess of the deduction claimed (the property's fair market value) over its basis on the date of contribution. The charity is now required to file a [Form 8282](#) (Donee Information Return), if the property is sold within three years of contribution, rather than within two years of contribution under prior law.

An exception. An exception applies and the donor is not required to recapture only if the charity certifies under penalties of perjury that the property was either (i) used by the charity in furtherance of its exempt purposes, or (ii) intended to be used by the charity in furtherance of its exempt purposes and the use became "impossible or infeasible to implement."

Penalties. A \$10,000 penalty applies to a person who identifies property as related to a charitable use knowing that it is not intended for such a use.

This provision is effective for contributions made and returns filed after September 1, 2006. For penalty purposes, this section applies to all certifications provided after August 17, 2006.

## III. Section 529 College Savings Plans

Qualified Tuition Programs ("QTPs") have steadily increased in popularity since the enactment of [Code Section 529](#). QTPs allow a contributor to establish a qualified tuition account (an "Account"), for the benefit of a designated beneficiary (a "Beneficiary"), for the payment of qualified higher education expenses (i.e., tuition, fees, books, supplies, and equipment) (the "Expenses"). Contributions to an Account are not taxable to the Beneficiary, and they accumulate tax-free, provided the funds are ultimately used to pay permitted

Expenses.

[The Economic Growth and Tax Relief Reconciliation Act of 2001](#) (“EGTRRA”) [3] amended several key tax aspects of [Code Section 529](#). However, the amendments were scheduled to expire (i.e., “sunset”) at the end of 2010. While the original intent of [Code Section 529](#) was to encourage financial planning and college savings, the uncertainty surrounding the potential expiration of the tax benefits of [EGTRRA](#) created some level of uncertainty for potential contributors regarding the long-term value and tax benefit of QTPs.

[Section 1304 of the PPA](#) removed this ambiguity by permanently extending all provisions of [EGTRRA](#) that were previously scheduled to expire at the end of 2010.

#### **IV. Public Disclosure of Forms 990-T (Unrelated Business Income Tax Returns)**

Historically, organizations that are recognized as [Code Section 501\(c\)\(3\)](#) organizations were required to file a [Form 990](#) each year with the Internal Revenue Service (“IRS”), and were required to make the [Form 990](#) available to the general public upon reasonable terms. In recent years, the [Form 990](#) has become widely available, without a request, through publication on the Internet at [www.guidestar.org](http://www.guidestar.org). In contrast, organizations filing an unrelated business income tax (“UBIT”) return ([Form 990-T](#)) were not historically required to make the return publicly available.

[Section 1225 of the PPA](#) changed this dynamic for [Code Section 501\(c\)\(3\)](#) organizations and places the [Form 990-T](#) on the same footing as the [Form 990](#). Both are now subject to public disclosure, which may very well lead to the publication of [Forms 990-T](#) on [Guidestar](#) for future tax years. This requirement will likely invite public scrutiny of an organization’s unrelated income and expenses. Most communities have witnessed newspaper or magazine articles devoted to the compensation practices of charities, with the information gleaned from [Forms 990](#). It is reasonable to assume that this new transparency of a college’s or university’s [Form 990-T](#) may invite similar public interest and debate. Therefore, it is important that institutions carefully consider their UBIT tax positions and the information and message that they publicly communicate through their [Forms 990-T](#).

#### **V. Reform Measures Directed at Supporting Organizations**

One of the most significant impacts of the [PPA](#) is arguably the reform measures directed toward supporting organizations described in [Code Section 509\(a\)\(3\)](#) [4]. Many colleges and universities have formed affiliates (e.g., foundations, endowments, technology transfer entities, exchange programs, research institutions, captive insurance companies, etc.) that are classified as supporting organizations by virtue of their close relationship with the college or university [5].

As such, the [PPA](#) may impact an institution significantly through its impact upon the institution’s affiliates.

There are four different types of supporting organizations: (a) Type I [6]; (b) Type II [7]; and (c) Two distinct Type III supporting organizations [8]: (i) Functionally Integrated Type III [9], and (ii) Nonfunctionally Integrated Type III [10].

##### Charitable Distribution from an IRA

While the [PPA](#) permits charitable distributions from IRAs, they are not permitted to be made to supporting organizations. In other words, a potential donor would need to direct the IRA distribution directly to the college or university, or to a foundation or endowment that is not classified as a supporting organization within the meaning of [Code Section 509\(a\)\(3\)](#).

##### Private Foundation Grants to Supporting Organizations

The [PPA](#) significantly restricts private foundation [11] grants (and donor advised fund grants) [12] to certain

supporting organizations, and imposes two types of excise (or penalty) taxes upon private foundations that make grants to Nonfunctionally Integrated Type III supporting organizations [13]. However, there is no reliable source that currently identifies the supporting organizations that are classified as Nonfunctionally Integrated Type IIIs.

In sum, the PPA places a penalty on private foundation grants to certain types of charities, and understandably, private foundations have reacted by increasing their scrutiny of pending grants until the IRS can give further guidance regarding the identity of the charities that are the subject of the new restrictions in the PPA [14].

### **What steps can an institution take to protect private foundation funding to its supporting organization?**

(a) Communicate with each private foundation that is a current or prospective funder to determine the policies it has developed in response to the PPA.

In a positive recent development, the IRS issued Notice 2006-109, which outlines the appropriate documentation upon which private foundations may rely in making grants to supporting organizations. These guidelines remove the ambiguity regarding the level of review that a private foundation must undertake prior to funding a supporting organization.

A supporting organization can facilitate a private foundation grant by providing the following information in conformance with Notice 2006-109:

- A current IRS determination letter;
- A copy of its governance documents demonstrating its relationship with its supported organization;
- If the organization is a Type I or Type II supporting organization, it may provide a written representation to the private foundation (signed by an officer, director or trustee) that includes the following information:
  - A statement regarding its status as either a Type I or Type II supporting organization; and
  - A description of how its officers, directors or trustees are selected, and a reference to the relevant portions of its governing documents that establish its relationship with its supported organization; or
- If the organization is a Functionally Integrated Type III supporting organization, it may provide a written representation to the private foundation (signed by an officer, director, or trustee) that includes the following information:
  - A statement regarding its status as a Functionally Integrated Type III supporting organization; and
  - The name of its supported organization(s).
- In addition, the supported organization must provide a written representation (signed by an officer, director, or trustee) that includes the following information:
  - A description of the supporting organization's activities and the manner in which these activities are integrated with the supported organization's purpose or activities; and
  - A representation that, but for the involvement of the supporting organization, the supported

organization would carry out the purposes and activities described in the previous point.

- In lieu of the written representations outlined above, a private foundation is permitted to rely upon a reasoned written opinion of its counsel, or counsel for the supporting organization, concluding that the organization is a Type I, Type II, or Functionally Integrated Type III supporting organization.
- As a final point, the private foundation is not permitted to rely upon the written representations outlined above if the supporting organization's governance documents (as provided) are inconsistent with the representations. Therefore, it is very important that each supporting organization closely scrutinize its governance documents and ensure that they clearly establish the intended governance relationship with its supported organization.

(b) The IRS has not historically provided detailed classification information in its determination letters for supporting organizations. However, since passage of the [PPA](#), the IRS has started to issue more detailed letters providing Type I, II, or III status. At this time, we do not believe the IRS has begun to provide the necessary language for Type III organizations (i.e., Functionally Integrated or Nonfunctionally Integrated). In any event, supporting organizations should carefully consider requesting an updated determination letter from the IRS, describing the specific classification as Type I, II or III (and Functionally Integrated or Nonfunctionally Integrated), as such evidence would be conclusive for purposes of encouraging private foundation gifts.

(c) Organizations that can qualify as public charities by virtue of [Code Section 509\(a\)\(1\)](#) or [509\(a\)\(2\)](#) should consider seeking reclassification of their public charity status pursuant to the IRS process recently outlined in [Internal Revenue Service Announcement 2006-93 \[15\]](#). This process may be particularly useful for public university affiliates requesting reclassification as an organization defined in [Code Sections 509\(a\)\(1\)](#) and [170\(b\)\(1\)\(A\)\(iv\)](#).

(d) Supporting organizations should involve their finance officer, tax advisor and tax return preparer in this analysis to ensure that their financial, tax and reporting positions are uniform and consistent

## **VI. Intermediate Sanctions and Supporting Organizations**

The [PPA](#) also made a subtle, but significant, change to the intermediate sanctions regime [\[16\]](#) that will require compliance efforts on behalf of many colleges and universities [\[17\]](#). Specifically, if a college or university has an affiliate that is a supporting organization, then a “disqualified person” of the supporting organization is also a “disqualified person” of the supported organization. This will pose significant risk (i.e., exposure to the excise tax outlined in [Code Section 4958](#) for the disqualified person and the college or university’s directors or officers) if the college or university pays compensation to the disqualified person for the performance of services and does not meet the criteria for automatic excess benefit transactions as outlined in [Treas. Reg. § 53.4958-4\(c\) \[18\]](#).

An example may help illustrate this new provision:

Assume that College X has an affiliate, Program Y, which is a supporting organization. Dean P is an employee of College X, but does not otherwise meet the criteria in effect prior to the [PPA](#) to be considered a disqualified person of College X (i.e., she is not a director, officer, or key employee, and does not exercise substantial control over the affairs of College X). Dean P is a member of the board of directors of Program Y. As a result of the [PPA](#), Dean P is now considered a disqualified person of both College X and Program Y, and since College X pays compensation for personal services to Dean P, then it must satisfy all of the criteria outlined in Note 18 to avoid an automatic excess benefit transaction and the associated penalties.

### **What can your institution do to mitigate its risk in these situations?**

- Institute compliance efforts to ensure that your institution has an inventory of its supporting

organizations and an identification of the disqualified persons with respect to each supporting organization.

- Have procedures in place to satisfy the criteria outlined above when paying compensation to disqualified persons.
- Ensure that each organization (the college/university and the supporting organization) consistently and uniformly report the compensation to any disqualified person that provides services to both organizations. This issue is particularly important, for purposes of disclosure on the [Form 990](#), if one organization pays compensation as an intermediary for the other [\[19\]](#).

## CONCLUSION:

The [PPA](#) represents a significant legislative development for colleges and universities. As the legislation introduces many novel concepts and issues, only time will reveal its true impact upon the charitable community. The [PPA](#) also involves complex finance and tax issues, and it will be important for each college and university to understand its impact and involve a team that includes institutional counsel, the finance officer, tax advisor, and tax return preparer.

## [FOOTNOTES](#)

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## RESOURCES FOR COUNSEL:

### NACUA Resources:

- [“Problem Gifts and Prudent Investments,”](#) Gordon L. Beeman, NACUA Annual Conference 2006.
- [“Problem Gifts and Prudent Investments,”](#) Quin R. Frazer, NACUA Annual Conference 2006.
- [“Problem Gifts and Prudent Investments,”](#) A.L. (Lorry) Spitzer, NACUA Annual Conference 2006.
- [“Key Issues in Tax Law,”](#) Joseph R. Irvine, Bertrand M. Harding, and Sean Scally, NACUA Annual Conference 2006.

### Statutes:

- Internal Revenue Code Sections
  - [115](#)
  - [401\(k\)](#)
  - [403\(b\)](#)
  - [501\(c\)\(3\)](#)
  - [509](#)
  - [509 \(a\)\(1\)](#)
  - [509 \(a\)\(2\)](#)
  - [509\(a\)\(3\)](#)
  - [529](#)

- [4942](#)
  - [4945](#)
  - [4958](#)
  - [170\(b\)\(1\)\(A\)\(iv\)](#)
  - [170\(b\)\(1\)\(A\)\(vi\)](#)
  - [170\(e\)\(1\)\(B\)\(i\)](#)
- [Pension Protection Act of 2006 \(H.R. 4\)](#)
  - [The Economic Growth and Tax Relief Reconciliation Act of 2001 \(P.L. 107-16\)](#)

### Internal Revenue Service Forms:

- [Form 8283](#)
- [Form 8282](#)
- [Form 990](#)
- [Form 990-T](#)

### Regulations:

- [Treasury Regulation Section 53.4958-4\(c\)](#)
- [Treasury Regulation Section 1.509\(a\)-4\(g\)](#)
- [Treasury Regulation Section 1.509\(a\)-4\(h\)](#)
- [Treasury Regulation Section 1.509\(a\)-4\(i\)](#)
- [Treasury Regulation Section 1.509\(a\)-4\(i\)\(3\)\(ii\)](#)
- [Treasury Regulation Section 1.509\(a\)-4\(i\)\(3\)\(iii\)](#)

### Additional Resources:

- [Joint Committee on Taxation's Technical Explanation of H.R. 4](#)
- [House Ways and Means Summary of the Charitable Provisions of H.R. 4](#)
- [IRS Interim Guidance Regarding Supporting Organizations and Donor Advised Funds – Notice 2006-109](#)
- [IRS Transitional Guidance – Appraisal Requirements for Noncash Charitable Contributions – Notice 2006-96](#)
- [Internal Revenue Service Announcement 2006-93](#)
- [“Charitable Reform Legislation: President Signs Pension Protection Act of 2006”](#) by Marilee J. Springer and Gina M. Giacone
- [Guidestar.org](#)
- Council on Foundations, [“Pension Protection Act of 2006”](#)
- U.S. Department of Labor, [“Pension Protection Act of 2006”](#)
- TIAA-CREF, [“Pension Protection Act of 2006”](#)

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