



What the New Charities Law Means for You

On August 17, President Bush signed into law a bill that will impact grantmakers and donors. The new charitable provisions, part of the Pension Protection Act of 2006 (H.R. 4), include the first comprehensive regulation of donor-advised funds, as well as reforms or incentives that will affect private foundations, supporting organizations and individual donors. The provisions are many and complex, but here's a brief overview of what the new law could mean for you.

If You're an Individual Donor

If you have an IRA and are over age 70½: In 2006 and 2007, you can withdraw up to \$100,000 from your IRA tax-free if you give the money directly to charity. This does not include split-interest gifts (such as charitable lead trusts and charitable remainder trusts) and gifts to donor-advised funds, supporting organizations and private foundations. Although your withdrawal will not be subject to federal income tax it could be subject to state income tax, depending on whether the tax law in your state conforms to the new federal law.

If you itemize deductions: You must now have a bank record or written communication from a charity to support all monetary donations (cash, check or other monetary gift). You can no longer rely on your own written records.

If you donate clothing and household items: No deduction is allowed for contributions of clothing and household items unless the property is in "good used condition or better." You must now file a qualified appraisal with your tax

return for any single clothing or household item for which you claim a deduction of more than \$500.

If you donate non-cash property over \$5,000:

You must follow new requirements of what constitutes a "qualified appraiser," the appraisals must now be in accordance with generally accepted appraisal standards, and there are stiffer penalties for overvaluation (for income tax purposes) and undervaluation (for gift and estate tax purposes) of donations. The charity will have to report on any dispositions of donations within three years of receipt (increased from two years) on Form 8282. There are also new rules for gifts of tangible personal property intended for use by the charity to further its charitable purposes. If the charity disposes of the property within three years (increased from two years), your contribution will be reduced from fair market value to cost basis, unless the charity can prove to the IRS that continued use was impossible or infeasible.

If You're a Private Foundation

If you make grants to a Type III supporting organization: You can no longer count these grants toward your payout requirement, and you must exercise expenditure responsibility for the grants unless the Type III supporting organization is "functionally integrated" (see sidebar on page 4).

If you make grants to any type of supporting organization: You must exercise expenditure responsibility for these grants if a disqualified person of your foundation controls the

supporting organization or one of its supported organizations, and you cannot count such grants toward your payout requirement.

If You're a Community/Public Foundation

If you have one or more supporting organizations: Disqualified persons of your supporting organization(s) are now also considered disqualified persons of your foundation, even if they have no other relationship with your foundation, and you cannot enter into any transaction with these persons that will provide them with an excess benefit.

If you have any donor-advised funds:

- Your investment advisors (excluding your employees) for your donor-advised funds are now considered disqualified persons of your foundation and cannot receive more than fair market value for their services. This includes investment managers that manage or provide investment advice on assets maintained in your donor-advised funds, even if the investment pool is only partially funded by donor-advised funds. Penalty taxes are imposed on a disqualified person who receives an excess benefit and on organization managers who approve a transaction knowing that it is an excess benefit transaction.
- You and your organization managers will be subject to penalty taxes if a prohibited distribution (“taxable expenditure”) is made out of a donor-advised fund (see “If You’re a Donor-Advised Fund” on page 3).
- You must provide donors of new gifts to your donor-advised funds with a written acknowledgement that your foundation has exclusive legal control over the assets contributed, or else the donor cannot receive a tax deduction for the gift (effective for gifts made after February 13, 2007).

- You must report annually on your Form 900 the total number of donor-advised funds you own, the aggregate value of assets held in those funds, and the aggregate contributions to and grants from those funds during the year.

If You're a Supporting Organization

If you receive necessary services from a substantial contributor and/or his or her family: You can no longer pay any kind of compensation to them for these services. In addition to not paying compensation, you cannot make any grants, loans or similar payments (including expense reimbursements) to a substantial contributor, a family member of a substantial contributor or an entity in which they have more than 35 percent control. The definition of a “substantial contributor” is the same as for other public charities: a person who contributed or bequeathed to the supporting organization an aggregate amount more than \$5,000 and more than 2 percent of the total contributions and bequests received by the supporting organization in the taxable year in which the person’s gift or bequest is made.

If you're a Type III supporting organization: You are now subject to the same excess business holding rules that currently apply to private foundations. This requirement applies only to Type III supporting organizations that are not “functionally integrated” (see sidebar on page 4) and to Type II supporting organizations that are controlled by the supporting organization’s donors.

If you're a supporting organization of any type: You must now indicate on your Form 990 all of your supported organizations, what type of supporting organization you are, and a certification that your organization is not controlled directly or indirectly by one or more disqualified persons other than qualified representatives of your supported organizations.

If You're a Donor-Advised Fund

(under the new definition: see sidebar below)

- You cannot give grants to individuals.
- You cannot give grants to any entity for non-charitable purposes.
- You cannot make any grants, loans, compensation or other payments (including expense reimbursements) to donors, donor advisors, their family members and/or any entities in which they have more than 35 percent control. If a donor or donor advisor is also a service provider to your sponsoring organization, they can only receive payments from the sponsoring organization and not the donor-advised fund.
- You must exercise expenditure responsibility for grants to private non-operating foundations, Type III supporting organizations (except those that are “functionally integrated”), and Type I or II supporting organizations where the donor or advisor controls the supported organization.
- You are now subject to the same excess business holding rules that currently apply to private foundations.

Other Provisions

Other key provisions in the new charities law:

- **Increased fines and penalties:** The new law doubles fines and penalty excise taxes for violations by private foundations and their managers, and doubles the dollar cap (to \$20,000) for penalty excise taxes that can be imposed on managers of public charities for excess benefit transactions.
- **Study of donor-advised funds and supporting organizations:** The new law calls for the Treasury Secretary to conduct a year-long study of donor-advised funds and supporting organizations to determine if any other requirements (such as payout) are needed.

- **Public disclosure of UBIT Returns:** The current public inspection and disclosure requirements for Forms 990 and 990-PF have been extended to apply to UBIT returns (generally Form 990-T) for both private foundations and public charities.
- **Business donations of food and books:** In 2006 and 2007, businesses of any type can obtain a larger charitable contribution deduction for qualified food inventory donations to tax-exempt organizations, and C corporations can obtain a larger deduction for book inventory donations to elementary or secondary schools—if the books are used in the school’s educational programs.

More Information

The new law includes many other provisions and details not mentioned here. You can learn much more about the provisions from the **Council on Foundations** (www.cof.org/hr4) or **Independent Sector** (www.independentsector.org). Be sure to seek expert legal, tax or other professional advice to determine the impact of the new law for your particular circumstances.

New Definition of Donor-Advised Fund

The new charity law defines a donor-advised fund as a fund that possesses all three of the following characteristics:

- It is separately identified with reference to the contribution of a donor or donors (for example, the fund is named after a donor or persons related to the donor, or the organization’s books track contributions to the fund with respect to the specific donor(s)).
- It is owned and controlled by a sponsoring organization.
- The donor or a person appointed by the donor has, or must reasonably expect to have, the privilege of providing advice with respect to the fund’s investments or distributions.

Supporting Organization FAQs

What is a supporting organization?

Generally stated, a supporting organization is a 501(c)(3) that qualifies as a public charity because it provides meaningful support (financial, programmatic or both) to another public charity, and yields some degree of structural and operational control to that charity. Based on the relationship of the supporting organization to the public charity it supports, a supporting organization will be classified as a Type I, II or III.

What is a Type III supporting organization?

A Type III supporting organization operates with a greater degree of independence from the organization it supports than Type I or Type II supporting organizations. Typically the supported organization appoints one member of a Type III supporting organization's board and institutes other procedures to ensure that the supporting organization is responsive to it.

When is a Type III supporting organization “functionally integrated”?

A Type III supporting organization is considered to be functionally integrated if it performs the functions of, or carries out the purposes of, the supported organization and, but for the supporting organization, the supported organization would normally engage in these activities directly. For example, a Type III supporting organization that operates a printing press for a university would be considered functionally integrated because without the supporting organization the university would carry out the activity itself.

How do I determine whether a Type III organization is functionally integrated?

Only a careful review of the facts and circumstances of a particular organization will allow you to conclude if a Type III organization is functionally integrated. As a practical matter, only the potential grantee is in a good position to make such a determination. Until there are regulations or other guidance from the IRS to clarify what is acceptable due diligence, the Council on Foundations advises private foundations to consult with legal counsel to determine what procedures to following in awarding grants to Type III supporting organizations.

How can I tell if a grantee is a supporting organization?

Right now the easiest way to identify a supporting organization is to look in a charity's IRS determination letter for a mention that it is “an organization described in Section 509(a)(3),” which is the section of the IRS code covering supporting organizations, or to look at Part IV of Schedule A of the charity's Form 990, where supporting organizations are required to check box 13 to indicate the basis of their public charity status.

How can you tell a supporting organization's type (I, II or III)?

Form 990 for the 2005 tax year now requires a supporting organization to indicate its type in Part IV of Schedule A.

Source: Council on Foundations



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