

Pension Protection Act of 2006, Public Law 109-280
(signed by President Bush August 17, 2006)

- A. Title XII, "Provisions Relating to Exempt Organizations," changes the rules regarding charitable contributions, increasing reporting requirements, restricting private foundations through increased oversight, and raising the bar for donor advised funds and supporting organizations to avoid private foundation treatment.

- B. Charitable IRA rollovers are here: There is a new charitable rollover for IRAs, limited to \$100,000 annually (\$200,000 for married couples if both have IRAs) for persons who are 70 1/2 years old or over, applicable to 2006 and 2007 only. This benefit applies to traditional IRAs and to Roth IRAs (not to SEPs). The benefit is that a taxpayer can make a direct transfer of his IRA to charity without including the withdrawal in gross income, and without getting a charitable deduction. The net result is a 100% charitable deduction percentage on the gift. Donations to private foundations, supporting organizations and donor advised funds do NOT qualify, and the donor cannot receive anything of value in exchange for the gift. Finally, the rollover must be directly from the IRA to the public charity (not distributed to the plan participant and then to the charity), and the usual acknowledgment letters are still required.

- C. Other charitable changes and conservation easement enhancement in the Pension Protection Act:
 - (1) In 2003, deductions exceeding \$9 billion were claimed for gifts of used clothing to charity; in fact, CCH reported the figure was 48% of \$36.9 billion for clothing item deductions. Under the new law the Secretary of the Treasury is given the authority "in consultation with affected charities" to disallow such deductions unless the items contributed will be of meaningful use to the charity, and the clothing must be in "good condition."

 - (2) Any disposition by a charity of donated tangible personal property within three years (not two as under prior law) must be reported by the charity. And donors must now maintain (regardless of the amount) a bank record or a written acknowledgment from the charitable donee for all donations (so collection plate gifts are passé).

 - (3) The KETRA food donation rules have been extended to the end of 2007, and so has the enhanced deduction for books donated to public elementary and secondary schools by C corporations (available so long as the school actually uses the books in its educational programs).

- (4) Shareholders of S corporations may make contributions of the stock of the S corporation without losing S status, and now the shareholder's basis in the stock will be reduced only by the corporation's basis in the donated property rather than by the property's fair market value (as was the case under prior law).
- (5) The limits for deductions for qualified conservation easements have been raised from 30% to 50% of adjusted gross income; even 100% of AGI for contributions by qualified farmers or ranchers. This benefit extends to the end of 2007. [There is also a new façade easement for buildings in registered historical districts, with certain limitations if a rehab tax credit was taken, etc.]
- (6) There are increased penalties imposed on taxpayers and on appraisers for overvaluations and more strict rules apply to credit counseling agencies. In fact, under the new law even "taxidermy property" (that is, an item that contains "a part of the body of a dead animal") affords a deduction only to the person who "prepared, stuffed or mounted" the deceased and only in the amount of the donor's basis in the taxidermy property (rather than its fair market value), whether the gift will be used for a charitable purpose or not.
- (7) Watch out for gifts of fractional interests in tangible personal property: Under the new law, if a donor makes a gift of a fractional interest in an item of tangible personal property (a painting to an art museum, for example, which has been allowed in the past), then the donor must contribute all of his or her remaining interest in the item within the earlier of ten years after the initial gift or the donor's death. If the subsequent gift is not made, there is a complete recapture of past income tax and gift tax deductions for all previous contributions, with interest!! Also, there is a trap in the new law: the later gift of the balance of the donor's interest is calculated based on the lesser of the fractional portion of the overall value used in the initial donation or the value at the date of the completing gift. So if a painting doubles or triples in value over the period after the initial gift, there will be a taxable gift with no charitable deduction for the value of the interest transferred in excess of the calculated gift based on the rules in the new law.
- (8) Corporate owned life insurance provisions have been clarified: the highest-paid 35% of employees are eligible for corporate owned life insurance, and directors and persons with a 5% or more ownership in the company also qualify. Employers must provide notice to insured employees and obtain their written permission to be insured. Annual reporting and recordkeeping requirements are imposed on all contracts issued after the new law was passed.

- (9) Last but not least, the IRA and other true pension plan reforms in the new law: The Pension Protection Act of 2006 (PPA) is over 900 pages long (!), with more than 100 tax provisions. The true pension reform portions of the new law cover pension funding, hybrid plans, participant education, multi-employer plans and plan terminations; this law represents the first truly comprehensive pension legislation Congress has passed in more than 30 years. One important aspect of the legislation is the elimination of the 2010 sunset provisions under the old law, giving the new provisions the benefit of permanence. Among all the significant changes enacted, the nonspouse beneficiary “rollover” provisions will have perhaps the greatest significance to estate planners.

Under the law before PPA, a named beneficiary who was not the participant’s surviving spouse could not roll over distributions from a qualified retirement plan; instead, the entire distribution was income taxable to the recipient in the year of distribution. In fact, most retirement plans provide for lump sum distribution (so that the plan administrator need not be concerned about the red tape involved in stretching out distributions), even though minimum distribution rules did in fact provide for distributions over the designated beneficiary’s life expectancy.

Under PPA, distributions from a qualified retirement plan made after December 31, 2006 to a nonspouse beneficiary can be made directly to an inherited IRA. The amounts so transferred can be tax deferred and thereafter distributed over the life expectancy of the designated beneficiary as the minimum distribution rules provide. The distribution has to be a direct transfer to the inherited IRA. If a check is written to the designated beneficiary the roll over and resulting stretch out will be toast. This roll over benefit applies to individuals and to trusts as well, so a credit shelter or “Family Trust” can be the recipient of an inherited IRA, as can a marital or QTIP trust.

- D. But speaking of rollovers, spouses shouldn’t get greedy: In *Charlotte T. Gee, et vir. v. Com’r.*, 127 T.C. No. 1, 51-year-old Charlotte rolled over her 73-year-old deceased husband’s IRA into her own IRA and later requested a distribution before she reached age 59 1/2. She argued that because it was a rollover, she was immune from the 10% early withdrawal penalty. The Court disagreed, because she elected to treat the IRA as her own (not as an inherited IRA from her husband). So if a weeping widow wants withdrawals before she reaches age 59 1/2, she needs to think about that before electing a rollover of her beloved’s IRA.
- E. Don’t forget the Roth 401(k) innovation: The Roth 401(k) has arrived!! Beginning in January of 2006 owners of small businesses can save on taxes in their retirement and pass on wealth to their heirs tax-free using this new plan. The Roth 401(k) lets the investor accumulate the funds inside the plan tax-free

and withdraw tax-free as well, and the company-sponsored Roth 401(k) does not have strict income limits. Using after-tax dollars, owners get tax-free growth and tax-free withdrawals. Withdrawals must start at age 70 1/2, but a Roth 401(k) can be rolled over into a Roth IRA with no penalty. Come and get into it while you can because it looks too good to be true.