Gammon & Grange, P.C. July/August 2006

Nonprofit *Alert*®

Alerting nonprofit leaders to key legal developments and responsive risk management steps

Inside This Issue:

Nonprofit Alert is published bi-monthly by the Virginia law firm of Gammon & Grange, P.C.

Congress Passes Charitable Provisions; President Signs Today

Just before leaving Washington for their August recess, both the U.S. House of Representatives and the Senate approved the Pension Protection Act of 2006 (H.R. 4), attached to which are various charitable incentive and charitable reform provisions. Given the popularity of the pension provisions of H.R. 4, it passed handily, by a vote of 279-131 in the House and 93 to 5 in the Senate. President Bush signed the legislation today, August 17.

The charitable incentives and reforms in H.R. 4 are significant, though somewhat scaled back from those originally passed by the Senate in the Tax Relief Act of 2005 (which were eventually dropped in conference). Among the charitable incentive provisions in the Act:

- Tax-free rollovers from IRA's to public charities. NOTE: As passed, this incentive would expire after two years, and donor-advised funds, supporting organizations, and private foundations are not qualified recipients of rollovers.
- Enhanced deduction for contributions of food inventory.
- Payments received or accrued by certain exempt parent organizations from a controlled taxable subsidiary not be treated as unrelated related business income.

Among the charitable reform provisions in the Act:

- No charitable contribution deduction allowed for clothing and household item donations unless they are in good used condition or better.
- Stiffer penalties on donors who inflate the value of in-kind contributions.
- Increased donor substantiation requirements for cash contributions.
- Doubling of excise taxes imposed on certain prohibited activities by charities, social welfare organizations, private foundations, and exempt organizational managers.
- Various additional requirements (and potential penalties) on donor advised funds and certain supporting organizations.
- An annual IRS notification requirement for organizations with annual revenues less than $25,000 that are not required to file the Form 990.

While some in the charitable sector are relieved that the reform provisions in H.R. 4 are not as intrusive as previous proposals, this may not be the end of reform efforts. Senator Chuck Grassley (R-IA), Chairman of the Senate Finance Committee and the primary advocate of charitable reforms, declared his intention to work other Senators and IRS Commissioner, Mark

(continued on page 2)

Charitable Provisions...continued

Everson "to put together more legislative proposals to increase governance, transparency, and accountability in the non-profit sector."

If you would like a full list of the charitable provisions in the Pension Protection Act, please email us at npa@gg-law.com. For further information on TRUST Coalition, an alliance of charitable organizations promoting a research-based approach to charitable reform proposals, please contact Steve Kao at SSK@GG-Law.com.

Charity Surveys Prove Optimistic

The nonprofit community has suffered from an onslaught of negative publicity this past year—from mismanaged donations to ineffective governing boards—which has all been widely documented in the main stream media as well as past editions of this publication. Fortunately for charitable organizations nationwide, a silver lining to what's been a rather dark and cloudy year has finally appeared in the form of several recently released polls, all of which have portrayed our country to be a land full of charitable generosity and of a public character firmly committed to serving those in need.

According to a new Roper Reports Public Pulse survey, many types of charities—including various cultural, educational, health and religious organizations—are enjoying a greater degree of trust from donors, by as much as a 3 to 5 percentage point increase since 2003.

The data, which is based on 1,007 interviews conducted in person last December, shows that up to 30% of those polled had "a lot of trust" in religious organizations, while 26% trusted education groups to the same degree. Cultural institutions and health charities, while receiving a less empathetic "high level of trust" rating, displayed similar numbers at 25 and 22 percentage points respectively.

This rise in trust has paid off. That same Roper poll reports that in 2005, 42% of Americans donated either their time or their money to benefit social causes, which is a much bigger share than the 35% of Americans who made similar donations in 2004. This increase is partially accounted for by donations to last September's hurricane victims, as substantiated by a separate Roper poll conducted in November, which found that one-third of donors increased their giving for the year in response to natural disasters such as hurricanes Katrina and Rita.

So what were the social causes to which so many Americans lent their support in 2005? When asked last December, 52% of respondents said they supported rebuilding efforts for disaster relief; 31% contributed to education; and 27% donated to medical-research groups and organizations combating hunger.

When Americans were quizzed solely on whether they made a charitable donation last year, a Harris Interactive online poll found far more American donors than the Roper survey did, reporting that 9 out of 10 respondents answered in the affirmative. Roper officials believe that the discrepancy in the polls' outcomes can be attributed to the difference in language employed in each survey. When framed as a question of charitable giving (verses donation to social causes), respondents might have been prompted to include their contributions to religious institutions, cultural groups, and other organizations the Roper survey did not factor in as a "social cause."

Nevertheless, these numbers can only be taken as good news for nonprofits, especially when compounded with further optimistic news from the Washington-based Points of Light Foundation which reports that American volunteerism increased by nearly 12 percentage points from 2002 to 2005.

Using data provided by the Bureau of Labor Statistics and information from its own sources, Points of Light Foundation researchers assessed the average of the increase in number of volunteers by age and employment status, the hours they spent volunteering, and several other factors to calculate a single indicator of volunteerism.

While Americans aged 55 to 64 boasted the largest increase in volunteerism since 2002 (a 28% increase), it is the promising statistic showing a 14% increase for those aged 16 to 25 that has Points of Light most delighted. "People who start volunteering as youths tend to maintain that ethic of service as they age into

(continued on page 3)

Charity Surveys....continued

adulthood," says Christopher Toppe, Senior Social Scientist at the Points of Light Foundation.

The report also found that the number of hours Americans spent volunteering grew, but not as much as the number of volunteers: "More Americans may be doing occasional volunteer work rather than making sustained commitments," Toppe said.

Lack of Documentation = No Deduction

Recent reports show that Americans are making more charitable contributions than ever (see story above). This, of course, is a welcomed trend in the nonprofit community, which should, in turn, encourage charities to make sure that they show appreciation by providing donors with properly substantiated receipts.

In a recent Tax Court ruling, a woman was found to be lacking in the proper documentation for her charitable contributions because some of her receipts did not include all the language required by IRS regulations. Thus, her charitable contribution deduction was disallowed.

This woman claimed a charitable contribution deduction of $22,000 on her tax return for cash and property donated to her church and another charity. Throughout the year she had made various cash donations ranging from $125 to $1,200, along with a regular monthly contribution of $250 or more. Miscellaneous noncash properties, such as furniture and electronic equipment, were also donated, and valued at more than $250 but less than $5000.

To substantiate her claims after an IRS audit, she submitted receipts from her church that listed each contribution of cash and property. However, the IRS concluded that the receipts failed to substantiate any contribution of $250 or more because it failed to state whether the church had provided any goods or services in exchange for the contributions, as required by the tax code. Nor did the receipt contain a description of the property donated in detail reasonably sufficient under the circumstances. The Tax Court agreed with the IRS that her contributions of $250 or more were not deductible.

The lesson here to be learned is that anyone who makes a charitable contribution of $250 or more must make sure they have received a qualified receipt from the charity containing all required information. Without such a receipt, the charitable deduction will be denied by the IRS, even if other proof of payment is offered.

How do you know if your receipt is in correct form? For all contributions of $250 or more, the receipt must contain the following information:

1) the name of the charity;
2) date of contribution;
3) whether the donee organization provided any goods or services in consideration, in whole or in part, for the contribution; and
4) the details of either
a. the amount of cash donated, or
b. a description (such as age, quality, or condition) of any property other than cash contributed (the charity should not estimate the value of property gifts. It is the donor's responsibility to substantiate the value.)

And with the passage of charitable reforms in the Pension Protection Act of 2006 (see Page 1 above), cash contributions under $250 will only be deductible if substantiated by a receipt, cancelled check, or bank record showing the name of the donee organization, the date of the contribution, and the amount of the contribution. For additional information regarding substantiation requirements, including sample receipts, order Gammon & Grange's Nonprofit Alert Memo Charitable Gifts: Receiving and Receipting.

Reduction of Deduction

In Ian Koblick vs. Comm'r., TC Memo 2006-63, the Tax Court upheld the IRS's reduction of the donor's charitable income tax deduction from $720,000 to $450,000. Here's why:

The donor, Mr. Koblick, transferred his 45% interest in Sealodge International, Inc. to a charity in December 1994, while the other shareholders simultaneously did so as well. Mr. Koblick claimed a deduction of $720,000 on his tax return, calculated as the fair market value of his shares ($810,000) minus $90,000 the charity had paid him for his shares. He substantiated his deduction with a letter from the

(continued on page 4)

Reduction....continued

charity, which acknowledged the gift with an attached value determined by an engineer. A second appraisal report by another expert was submitted as well with Koblick's tax return.

The IRS disagreed with Koblick's valuation and had a second expert file an appraisal that determined the replacement cost to be different. Here's what they found: The IRSs expert determined that the replacement cost of the lodge to be at $1.1 million versus the $4.25 million claimed by Koblick's expert. However, the first report attached to Koblick's tax return reported a replacement cost of $1.97 million. The Tax Court used this value, and made several downward adjustments for depreciation, a minority interest discount, and other factors to uphold the IRS assessment.

There are several important messages one should take away from this case:

1. If you decide to submit multiple appraisals of donated property to the IRS, make sure they are consistent.
2. Valuation is the donor's responsibility.
3. The Tax Court is willing to apply valuation discounts for a minority interest and lack of marketability.
4. Under recently passed charitable reforms in the Pension Protection Act of 2006 (see Page 1 above), potential penalties for overvaluations of donated property have been stiffened.

GAO Report Finds CFC Charities Owe Taxes

A new report from the Government Accountability Office (GAO) finds that more than 1,200 charities that participate in the Combined Federal Campaign (CFC) owe federal taxes. Fifteen of the 1,200 organizations have been referred to the IRS for criminal investigation.

Most charities with employees are required to pay income tax withholding and Social Security and Medicare taxes, even though the organizations are themselves exempt from federal income tax. The GAO report found that 6 percent of CFC charities were delinquent, owing $10,000 or less; and that at least 15 charities owed significant amounts ranging from $400,000 to $1.5 million (including penalties).

Tribune Co. v. Tribune Foundation: Conflict of Interest

The Robert R. McCormick Tribune Foundation has found itself in a precarious position of late. As the price of Tribune Co. stock has fallen on Wall Street, which comprises 97% of the Foundation's assets, so has the pressure to sell its shares risen amongst the board members. The dual role of Dennis FitzSimmons as both the foundation's chairman and company CEO, however, creates an unenviable conflict of interest scenario for all parties involved.

"The degree of concentration in a single stock and the composition of the foundation's board, which is comprised entirely of current or former company executives, runs counter to the trend at other large foundations, which typically are run by independent boards and increasingly emphasize the diversification of portfolio assets," reports Philanthropy News Digest.

IRS Increases Determination Letter Fees

On July 1, the IRS increased determination letter fees for organizations applying for tax-exempt status. The fees, which previously ranged from $150 to $500, will now range from $300 to $750.

To Order Memos: Memos referenced in the Nonprofit *Alert* can be purchased for $20 each ($10 for clients) from Gammon & Grange, P.C. Five or more copies of the same memo are bulk priced at $5 each. Visit the **Nonprofit *Alert* Memo Page** for details.
To Subscribe: The NPA is a free publication with no login or password required. Visit the **Nonprofit *Alert* Page** to view current and past issues. Send an email to **NPA@GG-Law.com** to be added to the new issue notification email list.

Nonprofit *Alert*®
8280 Greensboro Drive, 7th Floor, McLean, VA 22102-3807 • (703) 761-5000
Fax: (703) 761-5023 • E-mail: npa@gg-law.com

Editor-in-Chief . . . . . . George R. Grange II *Editors. . . . . .Steve King and Claire Daniel*
Publications Coordinator. . . . . .Jo-Anne Kehmna *Layout Design/Web Designer . . . . . .Thomas Jubb*

Nonprofit Alert is published bi-monthly by the law firm of Gammon & Grange, P.C., which represents nonprofits nationwide. References in **Nonprofit Alert** in no way constitute an endorsement by **Nonprofit Alert** or by Gammon & Grange, P.C. **Nonprofit Alert** is distributed with the understanding that no legal, accounting or other professional services are rendered, and no attorney/client relationship is established. If legal advice or other expert assistance is required, the services of a professional should be formally engaged.