CHARITABLE GIVING INCENTIVES AND REFORMS IN THE PENSION PROTECTION ACT

Many of the 'reforms' create harsh penalties and limitations not narrowly tailored to apply only to abusive contributions.

M. RUTH M. MADRIGAL

Many in the charitable sector breathed a sigh of relief when most of the long-debated charitable provisions introduced in the Senate's 2005 tax reconciliation bill (S. 2020, 109th Cong, 1st Sess. (2005)) and later included in the Senate's version of H.R. 4297 (109th Cong, 2d Sess. (2006)), were dropped from the tax reconciliation bill in May 2006. Although some of the incentives in that bill were enticing (such as a nonitemizer deduction and an IRA charitable rollover provision), many of the other provisions were troubling (such as a charitable contribution floor tied to the nonitemizer deduction).

There were rumors that a revised charitable package might be attached to the pension bill that had been mired in conference committee for weeks, but as weeks turned into months and Congress' traditional August recess neared, most practitioners quit watching Congress and went on with their summer vacations. Then, in the final few stifling days of July, with little warning and no chance to review the final legislative language (let alone comment on it), the most far-reaching package of charitable tax provisions since 1969 was slipped into the Pension Protection Act of 2006 (PPA), passed, and signed into law two weeks later on 8/17/06.

The PPA's provisions were billed as a combination of charitable giving incentives and reforms relating to charitable contributions and charity operations. The charitable operational reform provisions in the PPA significantly alter the exemption, operating, and reporting requirements for charities and are discussed elsewhere in this issue.[1] The charitable giving incentive and reform provisions are summarized below.

Behind the charitable giving provisions in the PPA lie Congressional concerns that some donors have either overvalued charitable deductions or taken fair market value deductions for contributions of property that are not used to further a charity's exempt purposes, as well as the suspicion that charities have been complicit in such abuses. The overvaluation of contributions of property and the inappropriate treatment of property contributions that do not, in fact, further exempt purposes both result in the taking of excessive deductions by donors and a loss to the fisc.

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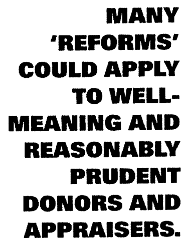
Whenever changes to the charitable giving provisions of the Code are considered, however, care should be taken to narrowly tailor the provision so as not to jeopardize the stream of charitable contributions that sustains the work of the sector. While some of the PPA provisions are indeed much-needed reforms designed to stop perceived abuses, other provisions are much harsher and far broader than necessary. Among these are severe penalties that could apply to many well-meaning and reasonably prudent donors and appraisers, and charitable giving limitations that may be the practical equivalent of denying a deduction for some charitable contributions. Thus, it seems that some of the PPA's charitable giving provisions may actually act as *disincentives* to giving.



MANY 'REFORMS' COULD APPLY TO WELL-MEANING AND REASONABLY PRUDENT DONORS AND APPRAISERS.

In contrast, the PPA's giving incentives are actually quite modest and short-lived. They are effective only for two years, the first of which is nearly over (although proponents in the charitable sector hope the provisions will be extended). Additional restrictions in the provisions, as well as questions regarding their applicability, are likely to further limit the actual benefit of the provisions seen by charitable organizations in the form of new or increased giving. Although some charitable groups lobbied heavily for the giving incentives that were finally included in the PPA, many in the sector are dubious about whether these incentives really will do much to spur additional giving. They are equally dubious about whether any such additional giving will be offset by the legitimate contributions lost due to the risks and costs imposed by the broad expansion of donor penalties and other giving disincentives included in the PPA.

The Treasury has not yet issued much guidance on PPA provisions[2] and there is little legislative history, so much is still unknown about how these provisions will be interpreted and operationalized. However, given the relative secrecy of the legislative process and lack of thorough examination of the legislative language by practitioners prior to passage,[3] exempt organization managers and professionals probably will find surprises and unintended consequences as they begin to examine these provisions in detail.

Modest incentives for giving

Although a wide range of charitable giving incentives have had significant support from Congress and the charitable sector in recent years, few of the previously proposed incentives made it into the PPA, and those that were included generally are skimpy versions of their former selves. Because the provisions are effective for only two years, there is little time available for charities to publicize and for donors to take advantage of these incentives. Thus, they many not spur much additional giving. This is particularly true for new provisions whose application is not entirely clear, and for which Treasury guidance may not even be available before they expire.

IRA charitable rollover. The most significant giving incentive in the PPA, estimated by the Joint Committee on Taxation cost $856 million over ten years, is a scaled-back version of IRA charitable rollover provisions seen in earlier charitable legislation.[4] New Section 408(d)(8) temporarily allows taxpayers who have attained age 70½ to make "qualified charitable distributions" from their traditional or Roth IRA directly to most public charities, and to exclude from income the distributed amounts that otherwise would be subject to tax.[5] Because it excludes a charitable distribution from income, instead of requiring taxpayers to include the distributions in gross income and then claim a charitable contribution deduction, as is ordinarily the rule, the IRA charitable rollover avoids the usual percentage limitations on charitable contributions. This incentive is available only for distributions made in 2006 and 2007, and only for up to $100,000 per taxpayer per year. Qualified charitable distribu-

[1] Kawashima, Mills, and Louthian, "Pension Protection Act Adds Burdens and Taxes for Exempt Organizations," page 147 of this issue; Treacy, "Supporting Organizations After the Pension Protection Act," page 163 of this issue.

[2] On 10/19/06, the IRS issued the first guidance relating to the PPA. Notice 2006-96, 2006-46 IRB 902, provides temporary guidance regarding the definitions of "qualified appraiser" and "qualified appraisal," added by the PPA.

[3] Williams, "President Bush Signs Charity Provisions Into Law," Chronicle of Philanthropy at http://philanthropy.com/free/update/2006/08/2006081701.htm, quoting Steve Gunderson, President, Council on Foundations.

[4] Other previous legislative proposals containing similar, though more generous provisions, include the Charitable Giving Act of 2003, H.R. 7, 108th Cong., 1st Sess.; the CARE Act of 2003, S. 476, 108th Cong., 1st Sess.; Title III (CARE Act) of the Marriage, Opportunity, Relief, and Empowerment Act of 2005, S. 6, 109th Cong., 1st Sess.; the Charitable Giving Act of 2005, H.R. 3908, 109th Cong., 1st Sess.; Title II of the Senate-passed version of the Tax Relief Act of 2005, H.R. 4297, 109th Cong., 1st Sess.

[5] See PPA section 1201. Amounts excluded from income under this provision may not be deducted as charitable contributions.

tions will count as distributions for purposes of the traditional IRA minimum distribution requirements.

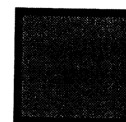
To be a "qualified charitable distribution," an IRA distribution must satisfy a number of requirements:

- The distribution must be made directly by the trustee of the IRA to the donee charity. Distributions to a taxpayer that are then given to charity are subject to the rules that have always applied to such distributions—they must be included in the taxpayer's income. Then, if the taxpayer itemizes deductions, a charitable deduction may be allowed, partially or fully offsetting the income.
- The distribution must be made to a public charity (described in Section 170(b)(1)(A)) but *not* to a supporting organization or a donor-advised fund.[6]
- The distribution must be made *on or after* the date the donor reaches age 70½ (not just during the year the donor reaches age 70½).
- A deduction for the entire amount of the distribution must be allowable under Section 170 (but for the application of the percentage limitation in Section 170(b) and this provision). Thus, if the donor receives a return benefit in exchange for the distribution, such as tickets to a banquet or performance, or fails to retain the necessary substantiation of the contribution, the distribution will not be a qualified charitable distribution and so will be included in income.[7]

The enacted provision is much narrower than earlier versions of an IRA rollover introduced in Congress. For example, the IRA rollover provision in S. 2020 would have allowed individuals aged over 59½ to make contributions either to charities or to split-interest entities (such as charitable remainder trusts and charitable lead trusts).[8] Legislation introduced in 2003 had the same sort of eligibility and flexibility for IRA rollovers as S. 2020 and, in addition, would have allowed rollovers from IRAs to all public charities, including both supporting organizations and donor-advised funds.

Some in the charitable sector have criticized this discrimination between different types of public charities.[9] Others have wondered whether this limited provision actually will spur much new giving, as donors who itemize deductions generally can already use the charitable deduction to reduce their taxable income for IRA proceeds given to charity.

The rollover provision primarily benefits older taxpayers who have either a low annual income (and thus, low percentage-of-income limitations) or relatively few itemized deductions (including charitable deductions), and thus may not benefit from the charitable contribution deduction. In this way, the IRA rollover provides a de facto non-itemizer deduction for older Americans able to make contributions from an IRA account. Many taxpayers with low annual incomes are not in a position to donate significant amounts to charity, however. This is particularly true given recent changes in the Medicaid asset transfer rules that, for purposes of qualification for Medicaid assistance, treat assets given to charity within five years of application as still being owned by the donor.[10]



THE GIVING INCENTIVES ARE ACTUALLY QUITE MODEST AND SHORT-LIVED.

Conservation contributions. Although contributions of historic façade easements are discouraged by another provision of the PPA, contributions of conservation easements by individuals—particularly farmers and ranchers—are encouraged. The normal percentage limitation on charitable contributions of capital gain property to public charities (30% of the donor's adjusted gross income, or AGI) will not apply to qualified conservation contributions made in 2006 and 2007.[11] Instead, Section 170(b)(1)(E) provides that a 50%-of-AGI limitation, applicable first to contributions *other than* qualified conservation contributions,

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[6] To take advantage of this giving incentive, a supporting organization that also may qualify as a public charity under Section 509(a)(1) or (a)(2)—for example, because it meets the public support test of Section 170(b)(1)(A)(vi)—may request that the IRS change its classification under Section 509(a). Announcement 2006-93, 2006-48 IRB1017. See "IRS Outlines Changing the Basis for Exemption in Response to the PPA," page192 of this issue.

[7] Staff of the Joint Committee on Taxation, *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," As Passed by the House on July 28, 2006 and as Considered by the Senate on August 3, 2006* (JCX-38-06, 2006) (hereinafter, "JCT Technical Explanation").

[8] See section 302 of S. 2020, 109th Cong., 1st Sess.

[9] See Council on Foundations press release of 8/4/06, available online at http://www.cof.org/council/prdetail.cfm?ItemNumber=5273&navItemNumber=3990.

[10] See Independent Sector, "Medicaid Asset Transfer rules Threaten Older Americans Who Make Charitable Donations" at http://www.independentsector.org/programs/gr/medicaidchange.html (describing changes in Medicare qualification enacted in the Deficit Reduction Act of 2005).

[11] "Qualified conservation contributions" are defined in Section 170(h).

it is the same as that of similar contributions by partnerships. This alignment is effective, however, only for two years, as the new provision applies only to contributions made in tax years beginning in 2006 and 2007.

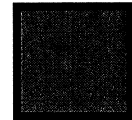
Charitable giving reforms and disincentives

When tinkering with the Code's charitable giving provisions, there is a fine line between preventing abuses and preventing much-needed charitable giving. Some of the PPA's recommendations closely follow those made by the Panel on the Nonprofit Sector in its June 2005 report.[21] However, several of the PPA's charitable reform provisions go far beyond the Panel's recommendations, creating potentially harsh penalties and deductibility limitations not narrowly tailored to apply only to abusive contributions.

The PPA addresses concerns of overvaluation by imposing stricter penalties on taxpayers and appraisers who overvalue contributed property. In addition, it specifically limits the deductibility of particular types of property and increases the substantiation requirements for even small gifts of cash. To address the concern that donors (and charities) were improperly identifying contributed property as intended for use in a charity's exempt function, the PPA provides for a recapture of the tax benefit if the property is disposed of within three years and tightens the rules relating to fractional gifts of property. It also adds a new penalty on charity managers who fraudulently certify that contributed property is intended for an exempt use.

Appraisers and appraisal standards. In its final report to Congress and the nonprofit sector in June 2005, the Panel on the Nonprofit Sector noted that (under then-current law) "the standards and definitions for qualified appraisals [were] vague" and that "problems have arisen due to the lack of clear, objective standards for establishing the fair market value of the donated property."[22] To improve the accuracy of the values claimed by donors as deductions, the Panel recommended strengthening appraiser and appraisal standards (and imposing new, tougher penalties on appraisers for improper valuations). The PPA added new definitions of "qualified appraisal" and "qualified appraiser" in Section 170(f)(11)(E) that are substantially the same as the Panel's recommendations,[23] along with appraiser penalties described in the next section, below.

To claim a deduction for a contribution of property valued in excess of $5,000, the law has for many years provided that a donor must obtain a "qualified appraisal" of the property and attach an appraisal summary (Form 8283) to the tax return on which the deduction for the contribution is claimed.[24] Prior to the PPA, a "qualified appraisal" was one that included certain specified information[25] and was performed by a "qualified appraiser." The term "qualified appraiser" was defined in the regulations as one who included certain items on the required appraisal summary, such as a description of his or her qualifications. That summary also must include a declaration that he or she (1) is a qualified appraiser holding him or herself out to the public as such, (2) is not related to the donor or related persons, and (3) understands the potential penalties that could be imposed for intentionally false or fraudulent overstatements of the value of the property.[26]



CONTRIBUTIONS OF CONSERVATION EASEMENTS—PARTICULARLY BY FARMERS AND RANCHERS—ARE ENCOURAGED.

The PPA expanded these definitions for appraisals performed with respect to returns filed after 8/17/06—an essentially retroactive effective date, given that appraisals must be commenced far in advance of the date of the transaction and the return is filed well after the transaction is complete. A "qualified appraisal" now must be performed by a qualified appraiser in accordance with generally accepted appraisal standards as well as any applicable regulations or other guidance provided by the Treasury.[27] In addition, the PPA defines a "qualified appraiser" as an individual who:

- Has an appraisal designation from a recognized professional appraiser organization *or* has met minimum education and experience requirements to be set by regulation.
- Is regularly paid to perform appraisals.

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[21] Panel on the Nonprofit Sector, "Strengthening Transparency Governance Accountability of Charitable Organizations, a report to Congress and the Nonprofit Sector" (June 2005) (hereinafter, "Panel Report").

[22] *Id.* at 53.

[23] *Id.* Indeed, the JCT's explanation of the provision relating to qualified appraisers is a nearly verbatim recitation of the Panel's recommendation on this point. See JCT Technical Explanation, *supra*, note 7 at 311.

[24] See Section 170(f)(11)(C); Reg. 1.170A-13(c)(2)(i).

[25] Reg. 1.170A-13(c)(3)(ii).

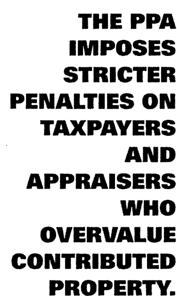
[26] Reg. 1.170A-13(c)(4)(ii)(K), Reg. 1.170A-13(c)(5)(i).

[27] Section 170(f)(11)(E)(i).

- Meets any additional requirements prescribed by the Treasury in regulations or other guidance.
- Can demonstrate verifiable education and experience valuing the type of property appraised.
- Has not been barred from practice before the IRS during the three years preceding the date of the appraisal.

On 10/19/06, the Service issued Notice 2006-96, providing transitional guidance on the new definitions of "qualified appraiser" and "qualified appraisal" added by the PPA.

Appraiser penalties for overvaluation. Under Section 6701, which remains in effect, an appraiser can be subject to a penalty of $1,000 for aiding and abetting an understatement of tax. The penalty attaches if he or she prepares an appraisal for use in the preparation of a return (e.g., as the basis for a donor's claimed charitable deduction), knowing (or having reason to believe) that the appraisal will be used in connection with a material matter arising under the internal revenue laws, and knowing that, if used, an understatement of the donor's tax liability will result. In addition, any appraiser with respect to whom a penalty has been assessed under Section 6701 can be barred from presenting evidence in any administrative proceeding before the Treasury and the IRS, and appraisals by such appraiser can be prohibited from having any probative effect in such proceedings.[28]



THE PPA IMPOSES STRICTER PENALTIES ON TAXPAYERS AND APPRAISERS WHO OVERVALUE CONTRIBUTED PROPERTY.

The PPA added a new penalty in Section 6695A, which provides that anyone preparing an appraisal to be used to support a tax position that results in a substantial or gross valuation overstatement (defined in the next section, below) is subject to a civil penalty equal to the greater of $1,000 or 10% of the understatement of tax resulting from the overstatement of value, capped at 125% of the appraisal fee. This penalty will not apply, however, if the appraiser can establish that it was "more likely than not" that the appraisal was correct. Query, however, how such a fact could be established. This exception appears to take the place of the usual reasonable cause exception, such as that available under Section 6664 to taxpayers who make a substantial valuation misstatement.

The PPA may have tipped the balance between preventing abuse and discouraging giving by eliminating the requirement that the Treasury assess the civil penalty for aiding and abetting an understatement of tax before an appraiser may be suspended or barred from preparing or presenting appraisals for tax purposes. This provision is somewhat worrisome, for without the prerequisite finding of willful misevaluation, it is unclear what standard will be used to make disciplinary decisions. Although enforcement of penalties against appraisers who knowingly exaggerate the value of donated assets is widely supported (even by appraisers),[29] appraisers now may risk losing the ability to practice their trade for making honest mistakes when appraising unique or otherwise hard-to-value assets.

In addition to raising appraisal fees, because the new appraiser provisions are potentially draconian and apply regardless of intent, appraisers may tend to understate the value of contributed property to reduce their own risk of liability, thereby reducing the incentive to donate the property to charity. Interestingly, there are no similar penalties for appraisers who *understate* the value of contributed property when hired by the IRS to challenge a taxpayer's claimed contribution value.

Taxpayer penalties for overvaluation. Under prior law, taxpayers claiming a charitable deduction for property incorrectly valued at twice the correct value were subject to a penalty of 20% of the unpaid tax resulting from the "substantial valuation misstatement."[30] In the case of a "gross valuation misstatement," occurring whenever the value of a claimed deduction was determined to be four times the actual value, a penalty of 40% of the unpaid tax resulting from the misstatement could be imposed on the taxpayer. These penalties would not be imposed if (1) the misstatement was due to reasonable cause and the taxpayer acted in good faith, (2) the claimed value of the property was based on a qualified appraisal made by a qualified appraiser, and (3) in addition to obtaining such appraisal, the taxpayer made a good faith investigation of the value of the contributed property (the "reasonable cause" exception).[31]

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[28] 31 U.S.C. section 330(c).

[29] Letters to Sen. Charles Grassley (R-Iowa) and Sen. Max Baucus (D-Mont.) dated 4/15/05 from four professional appraiser organizations, available at http://www.appraisalinstitute.org/govtaffairs/downloads/ltrs_tstmny/Ltr_Fin_Comm_Aprl15.pdf.

[30] Section 6662, prior to amendment by the PPA.

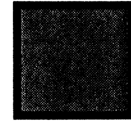
[31] Section 6664.

The PPA lowered the threshold for imposing these penalties for misstatements of value made on returns filed after 8/17/06.[32] Under revised Section 6662, a taxpayer now is subject to the 20% substantial valuation misstatement penalty if the claimed value of the contributed property is 50% higher than the correct value, and subject to the 40% gross valuation misstatement penalty if the claimed value of the property is twice the correct value. Significantly, the PPA also removed the reasonable cause exception in the case of gross valuation misstatements.

Because valuation is as much an art as a science, many taxpayers must rely on the advice of an appraiser as to the value of contributed property. The reasonable cause exception already required good-faith reliance on a qualified appraisal (the definition of which the PPA strengthened), and it seems unfair to penalize a taxpayer so harshly for an appraiser's error. This provision appears to apply even if the appraiser is not sanctioned—for example, where it can be demonstrated that it was more likely than not that the appraisal value was correct. Because of these provisions, donors may be reluctant to contribute rare, unique, or otherwise hard-to-value assets to charity unless some way is found to mitigate the risk of penalty for an appraiser's honest mistake.

Limitations on deductibility. All of the past year's talk in Congress about the need to simplify the Code apparently does not apply to Section 170. Continuing a trend of Section 170's "complexification," the PPA added more special rules restricting the deductibility of contributions of specific types of property thought to be particularly susceptible to overvaluation.

Because the primary concern with the following types of contributions seems to be the potential for overvaluation, the generally applicable provisions described above aimed at that problem (including new taxpayer and appraiser penalties) should be effective restrictions on the contributions discussed below, perhaps rendering these more specific changes superfluous.



A 'QUALIFIED APPRAISAL' MUST BE PERFORMED IN ACCORDANCE WITH GENERALLY ACCEPTED APPRAISAL STANDARDS.

Contributions of taxidermy property. At an April 2005 hearing, Senate Finance Committee chairman Charles Grassley (R-Iowa) expressed his extreme disapproval of reports of taxpayers taking hunting safaris in Africa at luxury lodges, bringing home and stuffing their quarry, donating the stuffed animals to charities, and taking a charitable deduction for the entire cost of the safari as well as the cost of stuffing.[33] To address this abuse, the PPA limits the amount of the charitable deduction that can be taken by any person who paid to have "taxidermy property" prepared, stuffed, or mounted to the cost of such preparing, stuffing, or mounting.[34] This provision is effective for contributions made after 7/25/06.

Contributions of historic and conservation easements. Also of concern to Congress were reports of taxpayers claiming large deductions for contributions of historic façade easements of arguably little or no value. In response, the PPA amended Section 170(h)(4) to restrict the availability of deductions for contributions of easements related to the exteriors of buildings located in registered historic districts (but not listed in the National Register) and increased the administrative burden and transaction costs associated with such contributions.[35] Such contributions will no longer be deductible, unless a number of new requirements are met.

- First, easements contributed after 7/25/06 must include a restriction preserving the entire exterior of the building (including front, rear, sides, and height) and must prohibit changes inconsistent with the historic character of the building.[36] Preserving the façade alone will no longer be sufficient.
- Second, the donee organization receiving such easements after 7/25/06 must certify (under penalty of perjury) that it is a qualified organization with a specified conservation purpose, and that it has both the resources and the commitment to enforce the restrictions in the conservation easement.[37]

[32] At the same time, the PPA similarly altered the thresholds for imposition of penalties for substantial valuation misstatements and gross valuation misstatements for gift and estate tax purposes. See Sections 6662(g) and (h)(2), as amended by the PPA.

[33] "Big-Game Hunting Brings Big Tax Breaks," Wash. Post, 4/5/05, Page A1.

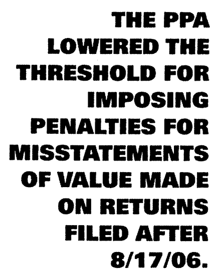
[34] See Sections 170(f)(15), (e)(1)(B)(iv).

[35] Contributions of historic buildings, structures, or land listed in the National Register are not subject to the additional requirements added by the PPA, nor are contributions of interests not relating to the exteriors of historic structures. In addition, the PPA eliminated structures (other than buildings) and land areas located in a historic district, but not listed in the National Register, from the definition of a "certified historic structure." See Section 170(h)(4)(C).

[36] Section 170(h)(4)(B)(i).

[37] Section 170(h)(4)(B)(ii).

- Third, beginning generally in 2007, the taxpayer must include with his or her return (1) a qualified appraisal of the easement, a description of all current restrictions on the property (including, for example, zoning laws, ordinances, neighborhood association rules, restrictive covenants, and similar restrictions), and, (2) to the extent practicable, photographs of the entire exterior of the building.[38]
- Fourth, beginning 2/13/07, for all such contributions with a claimed value of more than $10,000, a filing fee of $500 must be included with the taxpayer's return. The fee will be used for IRS enforcement relating to conservation contributions.[39]



THE PPA LOWERED THE THRESHOLD FOR IMPOSING PENALTIES FOR MISSTATEMENTS OF VALUE MADE ON RETURNS FILED AFTER 8/17/06.

In addition, if rehabilitation credits were allowed a taxpayer under Section 47 with respect to a building that is part of any conservation contribution, the taxpayer's deduction is reduced.[40]

Contributions of clothing and household goods. Ensuring that charitable contributions of clothing and household goods are appropriately valued is a particular challenge for the Service. Because numerous individual items of relatively low value (generally less than the donor's basis) are donated annually, the potential recovery for the Service is often much less than the cost of examining, determining, and collecting any additional tax due based on a contribution's improper valuation. Nevertheless, contributions of clothing and household goods are considered "a vital source of support for many charitable organizations,"[41] and are popular donations. Thus, proposals in this area in particular have tended to seek a balance between retaining incentives for such contributions and limiting the potential for overvaluation.

The Joint Committee on Taxation recommended a flat cap of $500 per year (regardless of filing status), which critics decried as arbitrary and unfair, while the Panel on the Nonprofit Sector issued the unwieldy recommendation that the IRS publish a list identifying the maximum deductible amount for contributions of a wide variety of items. Although the Senate's version of an earlier proposal embraced the Panel's recommendation, Congress took a different tack in the PPA and gave the Treasury authority to impose what could be a hefty "floor" on contributions of such property.

For contributions made after 8/17/06, Section 170(f)(16) denies a deduction to any contribution of clothing or a household item[42] that is not in at least "good used condition."[43] The definition of "good used condition," however, is left to be defined by practice and in guidance. Similarly, the PPA gives the Treasury the regulatory authority to deny a charitable deduction for "any contribution of clothing or a household item which has minimal monetary value,"[44] leaving that term, too, for later definition.

Neither of these two new provisions would apply, however, to contributions with a claimed value of more than $500 if the taxpayer includes a copy of a qualified appraisal of the property with his or her return.[45] This exception may give donors comfort that high value donations will remain eligible for a fair market value deduction. Unfortunately, the already-significant costs of appraisals are likely to be driven upward by the new appraisal standards and penalties discussed above, offsetting the deduction saved by this provision for items valued under $5,000 (the current general appraisal requirement threshold).

Another implication of this exception is that the "minimal monetary value" beneath which a contribution of clothing or a household item would be nondeductible may well be set at more than $500. When considered in this light, it seems that the PPA has effectively authorized the Secretary to institute a floor for charitable contributions of this type. This could become a model that would be extended to all contributions in the future. A general floor for charitable contributions, which was paired with

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[38] Section 170(h)(4)(B)(iii); see also JCT Technical Explanation, *supra* note 7 at 295.

[39] Section 170(f)(13).

[40] Section 170(f)(14).

[41] Panel Report, *supra* note 21 at 58.

[42] A "household item" is defined as including "furniture, furnishings, electronics, appliances, linens, and other similar items," but not including food, jewelry and gems, collections, and objects of art (including paintings and antiques). See Section 170(f)(16)(D).

[43] Section 170(f)(16)(A).

[44] Section 170(f)(16)(B).

[45] Section 170(f)(16)(C).

[46] See section 303 of S. 2020, 109th Cong., 1st Sess.; section 201 of the Senate-passed version of H.R. 4297, 109th Cong., 1st Sess.

[47] See, e.g., Council for Advancement and Support of Education, Washington Alert: Decmeber 21 (2005), "Proposed Changes to the Charitable Deduction" at http://www.case.org/Content/WashingtonWrapup/Display.cfm?CONTENTITEMID=5735.

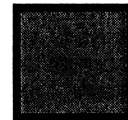
a popular provision giving non-itemizers an above-the-line deduction for charitable contributions in a prior version of the charitable package,[46] was among the most controversial of the charitable reforms sought by the Senate this year.[47] It appears that although the formal label of "contribution floor" was deleted, the concept was in large measure—and at a higher dollar value—retained, although only applicable to contributions of clothing and household goods for the moment.

Contributions of cash. Under prior law, a taxpayer needed no written acknowledgment from a donee charity to take a deduction for a cash contribution of less than $250. Under newly enacted Section 170(f)(17), however, cash contributions will no longer be deductible unless the donor obtains a receipt from the donee organization showing the organization's name, the date, and the amount of the contribution. For contributions made by check or "other monetary gifts," a donor may instead keep a bank record of the transaction with the same information (for example, a canceled check or bank statement showing an automatic debit to the charity). Because "bank record" is not defined in the statute, Treasury should clarify that a credit card receipt should also be sufficient substantiation of the contribution.

This provision applies to contributions made in tax years beginning after 8/17/06. For individual taxpayers, that means contributions made in 2007 and later years—sparing them (and the charities they support with spontaneous cash gifts) from the new requirements for one more holiday giving season. In addition to charities soliciting funds during the holidays, this provision may have a significant impact in faith communities, where members may make relatively small cash contributions on a regular basis or where a faith tradition may strongly encourage anonymous giving. In the past, a log of such contributions was sufficient documentation to support a donor's charitable deduction.

Tax benefit recapture and penalty for fraudulent certification of exempt use. Contributions of property used by the donee organization in furthering its exempt purpose ("exempt use property") are generally allowed a full fair market value deduction, while donors of tangible personal property not used by a charity in its exempt function are allowed to deduct only their basis in the property.[48]

For contributions of property made after 9/1/06, if a charity sells or otherwise disposes of charitable contribution property within three years of the contribution, the donor must recognize ordinary income in an amount equal to the difference between the deduction taken and his or her basis in the property—effectively limiting the deduction to basis—*unless* the donee organization describes and certifies the exempt use of the property (or certifies that the intended exempt use is impossible or infeasible) on Form 8282. If the property is disposed of during the tax year in which the contribution is made, the donor's deduction is limited to basis without exception.



OF CONCERN TO CONGRESS WERE REPORTS OF TAXPAYERS CLAIMING LARGE DEDUCTIONS FOR CONTRIBUTIONS OF HISTORIC FAÇADE EASEMENTS.

To align charity information reporting requirements with the new recapture provision, the PPA extended by one year (to three years from the date of the contribution) the requirement that charities disposing of charitable contribution property report such dispositions to the IRS on Form 8282 (with a copy to the donor). This change applies to returns filed after 9/1/06.

In addition, the PPA added a new penalty on charity officers (or any other persons) who identify "applicable property" as being charitable use property (e.g., on Form 8283), knowing that the property is not intended for such use.[49] The $10,000 penalty applies to such identifications made after 8/17/06, and applies in addition to any other penalties that may apply, such as the penalty (generally $1,000) under Section 6701 for aiding and abetting the understatement of tax liability. It would seem that this sizable penalty would be sufficient to deter the donor accommodation feared by Congress—that is, if it is imposed at least occasionally by the IRS.

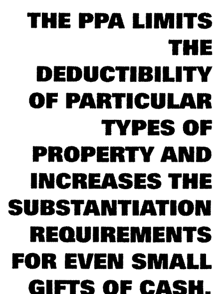
Contributions of fractional interests. A charitable deduction for a contribution of less than all of a taxpayer's interest in property is generally prohibited under Section 170(f)(3). An exception to this rule, however, allows a deduction for a contribution of an undivided portion of the taxpayer's entire interest in property, or a "fractional interest."[50] Gifts of fractional interests in artwork to museums, for example, have been quite common.

The PPA added significant new restrictions on the deductibility of charitable con-

[48] As noted elsewhere, the amount of the charitable contribution deduction may be otherwise limited, depending on the type of property contributed and the donee.

[49] Section 6720B.

[50] Section 170(f)(3)(B).



THE PPA LIMITS THE DEDUCTIBILITY OF PARTICULAR TYPES OF PROPERTY AND INCREASES THE SUBSTANTIATION REQUIREMENTS FOR EVEN SMALL GIFTS OF CASH.

tributions of fractional interests in tangible personal property made after 8/17/06. Under the PPA, the deduction for an initial donation of a fractional interest in property is determined in the same manner as under current law: if the property is used in a charity's exempt function, the deduction is based on the fair market value of the property at the time of contribution. For each additional contribution of an interest in the same property, however, the income, estate, and gift tax deductions now will be calculated using a deemed fair market value of the property equal to the lesser of (1) the value used for the initial fractional-interest contribution and (2) the fair market value at the time of the subsequent contribution.[51] This effectively denies a deduction for appreciation in the property after the initial gift, while requiring depreciating property to be revalued and a lower deduction to be taken on subsequent charitable gifts. A similar provision was predicted to discourage early contributions to charity of appreciating assets (such as artwork), with the likely result being that many such gifts would not be made.[52]

In addition, no income or gift tax deduction is allowed if, immediately prior to the gift, the property is owned by anyone other than the individual donor (or the donor and the donee charity). However, the Treasury may provide, by regulation, an exception allowing deductions for proportional contributions from all owners of the property.[53] This seems to deny the income and gift tax deductions to married donors who together contribute co-owned property unless and until the Treasury promulgates regulations specifically allowing such deductions.

Finally, the donor of a fractional interest in property must give all of his or her remaining interests in the property to the donee charity within ten years of the initial fractional contribution (or before the donor's death, if earlier).[54] In addition, between the date of the initial fractional gift and the donee's receipt of the remainder of the interests in the property, the donee must have "substantial physical possession of the property" and must use the property to further its exempt function or purpose. Any income or gift tax deduction taken for fractional gifts will be recaptured (with interest), and a 10% penalty will be added if these requirements are later not met.

Conclusion

It is unclear whether contributions—the lifeblood of the charitable sector—will be helped or harmed by the charitable giving provisions of the PPA. Taken together, there is good reason to fear that these provisions will do more to discourage charitable giving than the PPA's giving incentives will do to attract resources to the sector. ■

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[51] Sections 170(o)(2), 2055(g)(1), 2522(e)(2).

[52] See the ABA Section of Taxation's Comments on S. 2020 (2/3/06), page 18.

[53] Sections 170(o)(1), 2522(e)(1).

[54] Sections 170(o)(3), 2522(e)(3).

"Charitable Giving Incentives and Reforms in the Pension Protection Act," M. Ruth M. Madrigal, Taxation of Exempts, Volume 18/Issue 4, January/February 2007, Copyright © 2006, the Thomson Legal & Regulatory Group, or copyright owner as specified in the Journal.