

January 31, 2007

**ALERT: Tax-Related Changes for Tax-Exempt and Governmental Entities**

This past year was a busy one when it came to Congressional efforts to “reform” perceived abuses and bring about increased transparency with regard to charities, charitable giving reform and other tax-exempt or governmental entity issues. Enacted legislation, relevant provisions summarized below, addresses a wide range of tax-exempt organization issues. These important changes to the Internal Revenue Code were contained in two laws. The Tax Increase Prevention and Reconciliation Act of 2005 (“TIPRA”), enacted and signed into law in May 2006 and the Pension Protection Act of 2006 (“PPA”) signed by President Bush in August of 2006, together constitute the most significant Internal Revenue Code changes for public sector organizations in decades. We have outlined several of the more significant changes below, along with their potential impact on your organization. If you have any questions about these or other topics, please call AGH at (316) 267-7231 for tax-exempt and governmental tax advisor Rich Ruvelson. Note that charitable organizations supporting governmental entities are subject to the provisions affecting charities.

**TIPRA**

**Penalties for participation in “listed transactions:** Tax-exempt entities, public colleges and universities and their managers or administrators are subject to penalties for participation in either a “listed” or “prohibited tax shelter transaction.” The amount of the penalty is severe, even if the entity did not know or had no reason to know it was participating in a prohibited transaction. For many entities, the context in which participation will arise will be the investment in alternative vehicles and may not be known until the annual Form K-1 has been received. The provision is effective for tax years ending after May 17, 2006.

**ALERT –** *For those entities with alternative investments, including investments in certain hedge vehicles, management should immediately discuss risks with appropriate investment managers.*

**Governmental Withholding:** Beginning in 2011, governmental entities will be required to withhold tax at the rate of 3% on certain payments for goods and services. The provision applies to non-wage payments and does not apply to entitlement programs and payments to other governmental and not-for-profit entities. Although there is a threshold of \$100 million in aggregate for payments to providers of goods and services, this provision, which was seen as a hidden way to pay for future tax reductions, could have a significant impact on state and local budgets. Businesses dealing with governmental entities are expected to add on a price increase to cover the withholding should this provision ever take effect.

**ALERT –** *Governmental entities should consider the impact of a potential 3% increase (in addition to anticipated inflation) in the cost of covered goods and services on their future operations and capital spending budgets, and raise their concerns as appropriate.*

**PPA**

**Disclosure of Unrelated Business Income Tax Return Form 990-T:** The act extends the present law disclosure requirements applicable to Form 990 to the Form 990-T Unrelated Business Income Tax Return for tax-exempt organizations. The Forms 990-T filed by state colleges and universities are, generally, not subject to disclosure. This provision is effective for tax returns filed after August 17, 2006.

**ALERT –** *For those entities which have not filed their 2005 Form 990 and 990-T, the 2005 990-T will now be subject to public inspection and disclosure.*

**Reporting Requirement for Disposed Contributed Exempt Use Property Extended to Three Years:**

Charitable organizations and governmental entities that dispose of contributed property for which the donor received a deduction of \$5,000 or more must report on Form 8282 dispositions of said property within three years of receipt. Under prior law, reporting was required for dispositions within two years of receipt. In addition to the information that is already required to be provided on the return, donees must also provide a description of the donee's use of the property, a statement of whether use of the property was related to the purpose or function constituting the basis of the donee's exemption and, if applicable, a certification of any such use. This provision applies to contributions made and returns filed after September 1, 2006. Under the new law, disposition within three years and failure to provide the IRS and the donor with the required statement of use will result in a donor's deduction being reduced from fair market value to cost basis. Note that PPA, also, contains new requirements for what constitutes a "qualified appraisal."

**ALERT –** *Recipients of donated property will now need to monitor the disposition of contributed property for a three-year period.*

**New Recordkeeping Requirements for Certain Charitable Contributions:** The Act provides that no charitable contribution deduction shall be allowed for any contribution of cash, check or other monetary gift *regardless of the amount*, unless the donor maintains a bank record or written communication from the donee organization showing the name of the donee organization, the date of the contribution and the amount of the contribution. The provision applies to contributions made in tax years beginning after the date of enactment – August 17, 2006 and would include contributions to governmental entities for which a contribution deduction is desired.

**ALERT –** *For 2007 calendar-year taxpayers, it appears that the cash contributions through means such as the Salvation Army bucket will no longer be an allowable charitable contribution under these new rules. Letters sent to donors substantiating contributions must now provide the date(s) of the contribution(s).*

**Exempt Organizations with Gross Receipts Under \$25,000 Must File an Annual Notice:**

Organizations normally having gross receipts below \$25,000 are currently excused from filing Form 990. The Act requires that these organizations furnish annually, in an electronic form, a notice containing the legal name of the organization, any name which the organization operates or does business, the organization's mailing address, Internet website address (if any), the organization's taxpayer identification number, the name and address of a principal officer and evidence of the organization's continuing qualification for exemption from the Form 990 filing requirement. This provision applies to notices and returns with respect to annual periods beginning after 2006.

**ALERT** – *Many small community-based organizations such as Little Leagues, parent- teacher organizations and booster clubs which have historically been under the threshold for filing an information return will now need to file the notices. Review those organizations you are affiliated with, either as a volunteer or as a board member, to determine filing requirements.*

**Supporting organizations:** The Act provides many new complex rules with regard to supporting organizations. Charitable organizations will have identified (or are in the process of identifying) in their 2005 Form 990, Return of Organization Exempt From Income Tax, if they were a supporting organization under section 509 (a)(3), whether they were a Type I, Type II or Type III. This analysis would include a careful review of the organization's IRS determination letter to determine if it is an Internal Revenue Code Section 509 (a) (3) organization. From this determination, a careful analysis of the organization's articles and bylaws and how it is operated will help determine the response to this question.

The New Act also defines a new division Type III supporting organization as a "Functionally Integrated" Type III supporting organization. A Functionally Integrated Type III supporting organization is not required under the new regulations to make payments to supported organizations because the activities of the supporting organization are performing the functions of or carrying out the purposes of such supported organizations.

Many charitable organizations that support a college, university or healthcare organization, as well as other charities and their parent companies, have been formed as supporting organizations under section 509 (a)(3). Some key provisions in the Act affecting supporting organizations include:

- All supporting organizations, regardless of the organization's gross receipts, must file a Form 990. On the Form 990, each supporting organization must indicate whether it is a Type I, Type II, or Type III supporting organization and list its supported organizations. Each supporting organization must certify that it is not controlled directly or indirectly by one or more disqualified persons. **Effective date** – Effective for returns filed for tax years ending after August 17, 2006.

- The Act provides that an organization defined under Type III must provide to each of its supported organizations such information as the Secretary of the Treasury may require to ensure that the supporting organization is being responsive to the needs or demands of the supported organizations. A supported organization is an organization described in section 509 (a)(1) or 509 (a)(2) for whose benefit a supporting organization is organized and operated. **Effective date** – Effective for returns filed for tax years ending after August 17, 2006.

**ALERT** – *The new determination letters issued by the IRS recognizing supporting organizations as exempt are now indicating the Type (i.e., Type I, II or III) of supporting organization. Historically, IRS determination letters did not provide this information. Existing supporting organizations must therefore analyze their articles, bylaws, and operations and make a self-determination as to Type. This has resulted in many filing issues for supporting organizations filing their 2005 Form 990. Supporting organizations of governmental entities which previously were not required to file Form 990 may now be required to file it.*

**Circular 230 Notice:** The federal tax laws authorize the Internal Revenue Service in some cases to impose an accuracy related penalty on an underpayment of tax. The information contained in this document is not tax advice, nor is it intended to be used as a substitute for tax advice. Nothing in this communication can be used for the purpose of avoiding any penalties that may be imposed by any governmental taxing authority or agency.