Anthony P. Curatola, Editor

Charitable Contributions by Individuals and the Pension Protection Act

BY JANET TREWIN, CMA, CPA, AND ANTHONY P. CURATOLA

Charitable contributions by taxpayers are a time-honored way of providing income for charitable organizations and tax deductions for the donors. Historically, the charitable contribution deduction rules have been less restrictive for gifts made to public charities than for those made to private foundations. In the past few years, however, the rules concerning the deductibility of charitable contributions have been tightened. The American Jobs Creation Act of 2004, for example, added reporting and substantiation rules for taxpayers who donate automobiles, boats, and aircrafts. These rules are tightened even more under the Pension Protection Act of 2006 (PPA).

Basic Rules for Charitable Contributions

In general, a taxpayer who itemizes deductions is allowed to deduct the fair market value (FMV) of property contributed to a qualified charitable organization (see IRC §501(c)(3)). (Remember, cash is property.) The amount of the charitable deduction may be reduced or limited depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer. In addition, if the donor receives an economic benefit from the contribution, the value of that economic benefit reduces the amount of the deductible contribution.

A taxpayer must maintain reliable written records regarding donations made to qualified charities in order to claim the deduction on the tax return. In the case of money contributions, the taxpayer generally must maintain a cancelled check, receipt, or other written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

For property contributions other than money, the taxpayer generally must maintain a receipt (if practicable) from the donee organization showing the name of the donee, the date and location of the contribution, and a detailed description (but not the value) of the property. If a receipt isn't practicable, the taxpayer must maintain reliable written records regarding the contribution. The information included depends on the factors surrounding the contribution, such as the type and value of property contributed.

In addition to the recordkeeping requirements, substantiation requirements must be satisfied

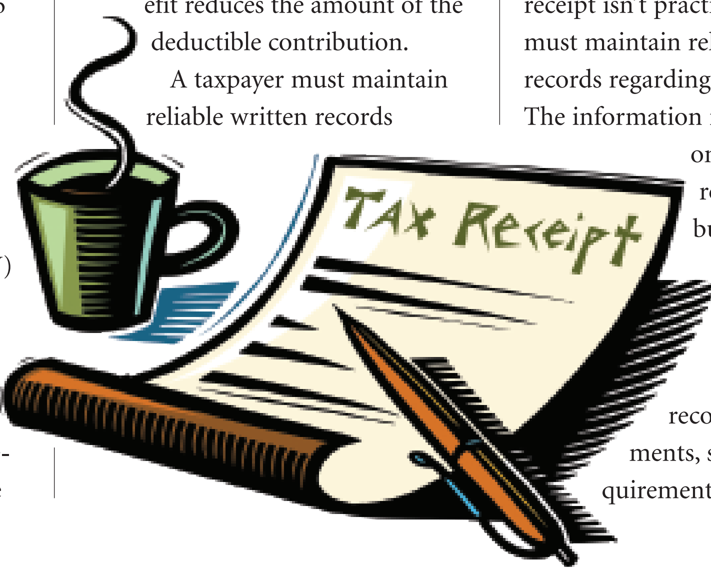

ILLUSTRATION: IMAGEZOO

when the contribution has a value of $250 or more. Substantiation means maintaining a contemporaneous written acknowledgment from the donee organization. This acknowledgment must include (1) the amount of cash, (2) a description (but not the value) of any property other than cash contributed, (3) whether the donee provided any goods or services in consideration for the contribution, and, if so, (4) a good faith estimate of the value of those goods or services. Furthermore, if the total value of the noncash property contributed is more than $500, Form 8283 (Noncash Charitable Contributions) must be attached to the tax return. If the value is more than $5,000, the taxpayer must obtain a qualified appraisal for the donated property and attach it to his or her tax return. Failing to satisfy the substantiation requirement may cause the charitable deduction to be disallowed.

PPA Changes: Basic Rules

For taxable years beginning after August 17, 2006 (which means you're safe for tax year 2006), PPA §1216 provides that no deduction is allowed for a charitable contribution of clothing or household items unless the clothing or household item is in good used condition or better. In addition, the Secretary is authorized to issue regulations denying a deduction for any contribution of clothing or a household item that has minimal monetary value, such as used socks and undergarments.

Not surprisingly, there are exceptions to this rule. An item of clothing or a household item (e.g., furniture, furnishings, electronics, appliances, linens, and other similar items) that isn't in good used condition or better is deductible if the amount claimed for the item (not items) is more than $500 and the taxpayer's return includes a qualified appraisal with respect to the donated property. Exceptions to the minimal monetary value rule include food; paintings, antiques, and other objects of art; jewelry and gems; and collections.

The substantiation rules for charitable contribution of money, regardless of the amount, are now satisfied only if the donor maintains a record of the contribution in the form of a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution. In other words, a taxpayer can no longer satisfy the recordkeeping requirement for cash contributions under $250 by simply maintaining written records; you need a receipt or cancelled check.

Contributions of Taxidermy Property

For those of you (or your clients) who have enjoyed the adventure of a safari trip and, even better, its deductibility as a charitable contribution by donating the taxidermy property, PPA §1214 closed that door. Now the deductible charitable contribution of taxidermy property contributed by the person who paid for the preparation, stuffing, and mounting of the property (or who carried it out if the contributor did it himself) is the lesser of the taxpayer's basis in the property or the FMV of the property.

The taxpayer's basis includes only the direct cost of preparing, stuffing, or mounting, and it doesn't include the indirect costs of transportation relating to any aspect of the taxidermy or the hunting of the animal. Also not included are the direct or indirect costs related to the hunting or killing of an animal, such as the cost of equipment or for preparing the animal carcass for taxidermy. In other words, there's no deduction for the trip, any of the lovely toys taken on the trip, nor the cost of getting your trophy to the taxidermist.

Charitable IRA Contributions

PPA §1201 provides an exclusion for taxpayers who make a qualified charitable contribution in tax years 2006 and 2007 from their traditional or Roth IRAs. This exclusion is only available if the contribution is made on or after the date the IRA owner attains age 70.5, and the amount may not exceed $100,000 per taxpayer per taxable year. In addition, the distribution must be a direct transfer by the IRA trustee to a qualified organization or donor-advised fund. The good news is that the entire distribution would be allowed as a deduction under present law, ignoring the applicable percentage limitations. The provision doesn't apply to distributions from employer-sponsored retirement plans, including SIMPLE- and SEP-IRAs.

There are some nuances that apply to the restrictions. To begin with, qualified charitable distributions are taken into account for purposes of the minimum distribution rules applicable to traditional IRAs. A person is able to direct the minimum distribution to the charity, in whole or part, and avoid the tax. This provision can be doubly appealing to taxpayers in states that begin the state income tax calculation with the federal AGI amount or provide an exclusion for this transfer of funds.

The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable (under present law), determined without regard to the generally applicable percentage limitations. As noted in the Staff of the Joint Committee on Taxation committee report (JXC 38-06, August 3, 2006), if the deductible amount is reduced because of a benefit received in exchange or if a deduction isn't allowable because the donor didn't obtain sufficient substantiation, the exclusion isn't available with respect to any part of the IRA distribution.

In the case of a qualified charitable contribution coming from an IRA that has nondeductible contributions, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

Needless to say, if a person distributes more than the $100,000 maximum excludible amount, the excess amount would be included in gross income as a distribution. This rule is the opposite of the Roth IRA distribution rules, where the earnings are removed last.

For example: Sissy has a traditional IRA with a balance of $250,000, consisting of $50,000 of nondeductible contributions and $200,000 of deductible contributions and earnings. She has no other IRA. If Sissy makes a qualified charitable contribution of $100,000 in 2006, she would exclude the entire $100,000 transferred to the charitable organization. The remaining $150,000 would consist of $50,000 of nondeductible contributions and $100,000 of deductible contributions and earnings.

This isn't the end of the discussion on the changes to the rules applicable to charitable contribution deductions perpetrated by the Pension Protection Act of 2006. We will discuss more issues in future columns. ■

Janet Trewin, Ph.D., CMA, CPA, is an associate professor of accounting at the University of Nebraska at Kearney. She can be contacted at (308) 865-8107 or trewinj1@unk.edu.

Anthony P. Curatola is the Joseph F. Ford Professor of Accounting at Drexel University in Philadelphia, Pa. You can reach Tony at (215) 895-1453 or curatola@drexel.edu.