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RE: Pension Protection Act of 2006

On August 17, 2006, President Bush signed the Pension Protection Act of 2006 (the "Act"). The Act reforms single-employer defined benefit rules and multiemployer pension systems, provides legal certainty for hybrid pension plans, provides new disclosure rules for qualified plans and new rules for investment advice. In addition, as summarized below, the Act liberalizes rules pertaining to qualified plan payouts and rollovers, makes permanent numerous retirement savings provisions and makes changes for charitable contribution deductions and charitable organizations.

Liberalized Plan Payout and Rollover Rules

The following are some of the provisions in the Act that liberalize plan payout and rollover rules:

- After 2007, taxpayers will be permitted to make direct rollovers from qualified plans to Roth IRAs;
- For purposes of the 401(k) hardship distribution rule, "hardship" includes hardship of any beneficiary under the plan (not just a spouse or dependent);
- Effective for post-2006 distributions, non-spouse designated beneficiaries are allowed to make rollovers of inherited amounts in qualified plans, governmental Sec. 457 plans, or tax-sheltered annuities to their own IRAs (treated as inherited IRAs); and
- Effective for distributions in plan years beginning after 2006, defined benefit plans can make in-service distributions to age 62-or-older participants.

Retirement Savings Provisions Made Permanent

The Act makes permanent a number of retirement plan and IRA liberalizations that were added to the tax laws in 2001 but were set to sunset after 2010. By making the 2001 changes permanent, the new law preserves the advantages of higher employee contribution limits for employer plans, higher IRA contribution limits, more flexible plan rules, portability, a catch-up for those over 50 and an increase in employer contribution limits. The new law also makes permanent the saver's credit, which would not have been available after 2006 absent the extension.

Charitable Reforms

The Act also contains a package of provisions to provide Americans additional tax incentives to give more resources to the charitable community and help prevent abuse in the charitable sector. Some of the tax incentives are as follows:

- *Tax-free distributions from IRAs for charitable purposes.* Taxpayers can exclude from gross income certain distributions of up to \$100,000 from a traditional or Roth IRA if made to a tax-exempt organization to which deductible contributions can be made. The provision is effective for 2 years through 2007.
- *Charitable deduction for contributions of food inventory.* An enhanced deduction for donations of food inventory which was formerly available only to C corporations is extended to all trades and businesses, effective for 2 years through 2007.
- *Basis adjustment to stock of S corporation contributing property.* If an S corporation contributes property to a charity, an S corporation shareholder only has to reduce his basis in stock of the S corporation by his pro rata share of the adjusted basis of the contributed property, rather than by the amount of the charitable contribution that flows through to him. The provision is effective for 2 years through 2007. (On a side note, the IRS intends to audit 5,000 S corporations through 2007 for the IRS' tax law compliance study.)
- *Qualified conservation contributions.* The new law raises the charitable deduction limit – from 30% of adjusted gross income to 50% - for qualified conservation contributions, as long as it does not prevent the use

of the donated land for farming or ranching purposes. The charitable deduction limit is raised to 100% of adjusted gross income for eligible farmers and ranchers. Unused contributions can be carried forward up to 15 years. The provision is effective for 2 years through 2007.

Among other reformations to prevent abuse in the charitable sector, the new rules:

- Double the fines and penalties applicable to certain activities by charities, social welfare organizations, private foundations and exempt organization managers;
- Clarify the terms of façade easements in historic districts and also clarify that the charitable deduction is reduced if a rehabilitation tax credit has been claimed with respect to donated property;
- Require the recapture of any tax benefit derived from the contribution of property with respect to which a fair market value deduction was claimed if the property is not used for an exempt purpose of the donee organization, effective for contributions of clothing and household items unless they are in good used condition or better;
- Require that in the case of a charitable contribution of money, regardless of the amount, the donor must maintain a cancelled check, bank record or receipt from the donee organization showing the name of the donee organization, the date of the contribution, and the amount of the contribution. This is effective for contributions made after the enactment date;
- Lower the threshold for imposing accuracy-related penalties on a taxpayer who claims a deduction for donated property for which a qualified appraisal is required;
- Apply an excess benefits transaction tax on any grant, loan, compensation or other similar payments from a donor-advised fund to a person that with respect to such fund is a donor, donor adviser, or a related person, and from a supporting organization to a substantial contributor or related person; and
- Require that unrelated business income tax returns of 501(c)(3) organizations be made publicly available.

Please note the above summary only highlights a few of the provisions in the Act. If you have any questions regarding the Act, please feel free to contact us.

Very truly yours,

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