THE GOOD, THE BAD AND THE UGLY
New Income and Charitable Tax Legislation in 2006


1. QUALIFIED DIVIDENDS AND LONG-TERM CAPITAL GAINS

a. Prior Law

(1) 15% maximum income tax rate for qualified dividend income and long-term capital gains, effective 2003–2008.

(2) 5% rate for lower-income taxpayers, effective 2003–2007, declining to 0% for 2008 only.

(3) 2006 Rates, Qualified Dividends and Long-Term Capital Gains.

<table>
<thead>
<tr>
<th>Married Filing Jointly</th>
<th>Single</th>
<th>Estate &amp; Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Income</td>
<td>Rate</td>
<td>Taxable Income</td>
</tr>
<tr>
<td>Not Over $61,300</td>
<td>5%</td>
<td>Not Over $30,650</td>
</tr>
<tr>
<td>Over $61,300</td>
<td>15%</td>
<td>Over $30,650</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Not Over $2,050</td>
</tr>
</tbody>
</table>

(4) in 2009, maximum capital gains rate would return to 20% for higher-income taxpayers—and to 10% for lower-income taxpayers.

(5) in 2009, all dividends would be taxed at ordinary income tax rates, as high as 35%.

b. TIPRA, amending Section 303 of the Jobs Growth Tax Relief Reconciliation Act of 2003, effective for 2009 and 2010

(1) Extends 15% maximum rate for qualified dividends and long-term capital gains through 2010, i.e. the favorable rate is effective for both 2009 and 2010.

(2) Extends the 0% minimum rate in effect for qualified dividends and long-term capital gains through 2010, i.e. favorable rate is effective for both 2009 and 2010.
c. **Client impact**

(1) Continuing ability to diversify investment concentrations at lower long-term capital gains rates.

(2) Expanded opportunities to gift appreciated long-term stock to lower-bracket family members, who can sell the gifted property (in 2008–2010) without paying capital gains tax.

(3) Continuing tax savings on qualified dividends.

**2. ALTERNATIVE MINIMUM TAX**

a. **Background**

(1) Purpose of the alternative minimum tax ("AMT"): enacted in 1978 to ensure all taxpayers pay their fair share of income tax.

(2) Applies to certain income otherwise sheltered from regular income tax by deductions (e.g. state tax payments) and exclusions (e.g. tax-exempt bond interest from private activity bonds).

(3) Tax at a maximum 28% rate is imposed on the excess of alternative minimum taxable income over regular taxable income.

(4) **AMT exemption**

   (a) Initial AMT exemption (1982):
       $40,000 for marrieds filing jointly; and
       $30,000 for singles.

   (b) Exemption increased in 1993 to:
       $45,000 for marrieds filing jointly; and
       $33,750 for singles.

   (c) Temporary increase (2004-2005)
       $58,000 for marrieds filing jointly; and
       $40,250 for singles.

       Temporary increase expired on December 30, 2005.
b. **TIPRA, amending IRC section 55(d)(1), effective for 2006 only**

Increases AMT exemption, for 2006 only,
to $62,550 for marrieds filing jointly; and
to $42,500 for singles.

c. **Client impact**

(1) This temporary increase will prevent an estimated 600,000 taxpayers from becoming subject to AMT in 2006.

(2) Temporary increase will also marginally reduce AMT liability for those already subject to AMT by shielding a few thousand more dollars of alternative minimum taxable income from taxation. AMT savings resulting from increase in exemption to $62,550 from $58,000:

\[
4,550 \times 26\% = 1,183
\]

(3) Only your client’s accountant can estimate how the increased exemption will affect that client’s AMT liability in 2006: there is no substitute for running the numbers—and the numbers are not final until year end.

3. **SMALL BUSINESS EXPENSING**

a. **Background**

(1) Since 1958, IRC section 179 has allowed small businesses to expense in the current year expenditures that would otherwise be depreciated over a number of years. Note: this provision is not available to estates and trusts.

(2) Under prior law, effective for tax years 2003–2007, the amount that could be expensed was increased from $25,000 per year to $100,000 per year.

(3) IRC section 179 only applies to businesses with relatively small annual investments in depreciable property. (The $100,000 expensing amount is reduced by the amount by which the cost of qualifying property placed into service in any year exceeds $400,000.)

(4) Both the $100,000 and $400,000 limits are indexed for inflation—e.g. increased to $108,000 and $430,000, respectively, in 2006.

**Example:** Sam’s Custom Shop places $430,000 of depreciable equipment into service in 2006. He can expense $108,000 of that equipment in 2006.
(5) In 2008, the $100,000 expensing limitation was scheduled to drop back to $25,000 and the $400,000 investment limitation was scheduled to drop back to $200,000.

b. **TIPRA, amending IRC section 179, effective for taxable years beginning after 2007 and before 2010**

Extends the $100,000/$400,000 small business expensing rules through 2009.

c. **Client impact**

For clients with small businesses (and who plan to place otherwise depreciable property into service in 2008 and 2009), this is good news.

4. **ROTH IRA CONVERSION OPPORTUNITY: $6.4 Billion Revenue Raiser?**

a. **Background**

(1) Contributions to a Roth IRA are not deductible.

(2) Qualified distributions from a Roth IRA are not taxable.

(3) Higher-income taxpayers cannot contribute to a Roth IRA.

(4) Ability to make annual contribution to Roth IRA phases out for marrieds filing jointly with modified AGI between $150,000 and $160,000; and for singles with modified AGI between $95,000 and $110,000.

b. **Prior Law: Converting Traditional IRA to Roth IRA**

(1) Higher-income taxpayers could not convert Traditional IRAs to Roth IRAs, either in part or in whole.

(2) Ability to a convert a Traditional IRA to a Roth IRA was limited to taxpayers with adjusted gross income of $100,000 or less.

c. **TIPRA, amending IRC section 408A(c) and (d), effective for taxable years beginning after December 31, 2009**

(1) Effective 2010, all taxpayers, including high income taxpayers, can convert all or part of a Traditional IRA to a Roth IRA. Income limitations will not apply.

(2) Whatever portion of the Traditional IRA is converted (except for after-tax contributions) will be taxed as ordinary income on the conversion.
(3) Taxpayers who convert in 2010 can elect to report the resulting income equally over 2011 and 2012 (instead of reporting all of the resulting income in 2010).

d. Client impact

(1) Assuming no further law changes, all qualified distributions made from the new Roth IRA after conversion would be tax-free. In contrast, distributions from a Traditional IRA would be subject to tax at ordinary income tax rates, rates that may well increase after 2010.

(2) Potential planning opportunities

(a) Between now and 2010, make non-deductible contributions to a Traditional IRA—and then convert the Traditional IRA to a Roth IRA in 2010.

(b) On retirement, roll over 401(k) to Traditional IRA and then convert Traditional IRA to Roth IRA in 2010.

The soundness of either plan depends on a number of unknowable variables, including future income tax rates, future tax law changes, future investment earnings, and date of death.

5. REPORTING TAX-EXEMPT INTEREST

a. Background

Although not itself taxable, tax-exempt interest affects numerous other tax computations, e.g. social security income subject to tax, investment interest expense deduction.

b. Prior law

Those who paid out tax-exempt interest (including custodians and investment managers like Northern) were not required to report the amounts paid to the IRS. Individual taxpayers reported tax-exempt interest on line 8b, page 1 of their Forms 1040.

c. TIPRA, amending IRC section 6049(b)(2), effective for interest paid on tax-exempt bonds after December 31, 2005.

(1) Tax-exempt interest is still tax-exempt.

(2) Payors will send the IRS reports of tax-exempt interest paid as part of their Form 1099 reporting.

(3) Clients are still required to report tax-exempt interest on their returns.
6. KIDDIE TAX PROVISIONS

a. Prior law
For children under age 14, net unearned income over $1,700 was taxed at the parent’s tax rate. Purpose: to prevent parents from reducing tax by artificially shifting investment income to children in lower income tax brackets.

b. Issues
(1) More incentives for income-shifting in 2008, when lower-bracket capital gains rate falls to zero.

(2) Income shifting to high-school age children was a popular technique for those planning to liquidate taxable investment portfolios to pay college tuition.

c. TIPRA, amending IRC section 1(g), effective for taxable years beginning after December 31, 2005
Increases the age, from 14 to 18, under which the “kiddie tax” provisions apply.

d. Client impact
(1) Only clients with children between the ages of 14 and 18 are affected.

(2) These individuals will now be unable to shift investment income—including capital gains to lower bracket offspring under the age of 18.

(3) Section 529 plans are still available for tax-sheltered college savings.

7. PROVISIONS AFFECTING U.S. CITIZENS WORKING ABROAD

a. Prior law
Section 911 lightens the tax burden of U.S. taxpayers working abroad by providing a foreign earned income exclusion and a foreign housing exclusion.

b. TIPRA, amending IRC section 911, effective for taxable years beginning after December 31, 2005
(1) Indexes the foreign earned income exclusion (maximum $80,000) for inflation beginning in 2006. Maximum exclusion in 2006 is $82,400.
(2) Limits the foreign housing exclusion to the excess of (i) 30 percent of the taxpayer’s foreign earned income exclusion over (ii) a base housing amount. Under this formula, the maximum foreign housing exclusion is $11,536 in 2006.

(3) Determines marginal tax rates applicable to non-excluded income by taking into account income excluded as either foreign earned income or as a housing allowance.

c. **Client impact**

(1) In Notice 2006–87, issued October 6, 2006, Treasury softens the impact of this provision by providing adjustments to the limitations on housing expense, based on geographic differences in housing costs.

(2) The tax burden on U.S. taxpayers working abroad has increased.

8. **PROVISIONS AFFECTING THE MUSIC INDUSTRY**

a. **Prior law**

Ordinary income treatment for proceeds of sale of self-created musical works/musical copyrights.

b. **TIPRA, adding new IRC section 1221(b)(3), effective for sales or exchanges before January 1, 2011 in taxable years beginning after May 17, 2006**

Taxpayers may elect capital gain treatment for sale or exchange of self-created musical works or copyrights in musical works created by the taxpayer’s personal efforts (or having an adjusted basis determined by reference to the basis of the property in the hands of the creator).

c. **Client impact**

(1) Relief is favorable, but limited.

(2) Income tax charitable deduction for contributions of self-created musical works/copyrights is still based on tax cost, not fair market value.
9. STIFF PENALTIES FOR TAX-EXEMPT ENTITIES PARTICIPATING AS ACCOMMODATION PARTIES IN PROHIBITED TAX SHELTER TRANSACTIONS

a. Background

(1) IRS and Congress are concerned about role of tax-exempts in facilitating tax shelter transactions.

(2) For a listed tax shelter transaction involving tax-exempts, see Notice 2004-30, 2004-17 I.R.B. 828, summarized below:

Taxable S corporation shareholders donate a portion of their S stock to charity X; S corporation allocates all its income to X for tax accounting purposes; S corporation makes no distributions while X is a shareholder; S corporation redeems its stock from X for a negligible amount; S corporation makes large cash distributions to the remaining taxable shareholders after X is redeemed. Charity has participated in the shelter; tax benefits (no taxable income) flow to taxable shareholders.

b. TIPRA, adding new IRC section 4965 and amending IRC sections 6011, 6033 and 6652. Generally effective for taxable years ending after May 17, 2006, with respect to transactions before, on or after that date, and for disclosures due after May 17, 2006. Complex transition rules.

(1) Defines “prohibited tax shelter transaction” to include listed transactions, as well as reportable transactions that are (i) confidential transactions or (ii) transactions with contractual protection. IRC section 4965(e).

(2) Applies to:

   (a) “plan entities,” including qualified pension, profit sharing and stock bonus plans; individual retirement accounts; and section 529 plans; and

   (b) “non-plan entities,” including organizations described in IRC section 501(c). IRC section 4965(c) and Notice 2006–65, I.R.B. 2006–31.

(3) Imposes stiff excise tax on “non-plan entities” that are accommodation parties to prohibited tax shelter transactions.

   (a) For participation without knowledge that the transaction was a “prohibited tax shelter transaction,” excise tax is generally imposed at highest corporate rate (35%) on the greater of (1) the entity’s net income with respect to the transaction or (2) 75% of the proceeds received by the entity from the transaction. IRC section 4965(b)(1)(A).
(b) For knowing participation, excise tax is greater of (i) 100 percent of entity’s net income from the transaction or (ii) 75 percent of gross proceeds received by entity from the transaction. IRC section 4965 (b)(1)(B).

(4) Imposes stiff excise tax on non-plan entities (including organizations described in section 501(c)) that are already parties to a transaction when it subsequently becomes a listed transaction. Pro-rated excise tax is imposed at the highest corporate rate (35%) on the greater of (1) the entity’s net income with respect to the transaction or (2) 75% of the proceeds received by the entity from the transaction. IRC section 4965(b)(1)(A).

(5) Imposes excise tax on managers of entities that are accommodation parties to prohibited tax shelter transactions—but only if the manager “knows or has reason to know that the transaction is a prohibited tax shelter transaction.” Tax is $20,000 for each approval (or other act causing participation.) IRC section 4965(b)(2).

(6) Requires that taxable parties disclose to tax-exempt parties that the transaction is a prohibited tax shelter transaction. Penalty for failure to disclose: generally, $10,000 for individual, $50,000 for others. Higher penalty if transaction is listed: $100,000 for individual, $200,000 for others. Amendment to IRC section 6011(g).

(7) Requires that tax-exempt entities disclose to IRS: (i) that they are parties to prohibited tax shelter transaction and (ii) identity of other known parties to the transaction. Penalty: $100/day, up to $50,000 maximum. Amendments to IRC sections 6033(a) and 6652(c)(3).

c. Client impact

(1) The limits of new section 4965 need further clarification. For example, guidance is needed to clarify when an entity becomes a party to a transaction and when an entity will be deemed to “know or have reason to know.”

(2) Tax-exempts and their investment managers should be counseled to view “extraordinary” or “exceptional” transactions with extreme caution, particularly if those transactions involve taxable parties.
B. PENSION PROTECTION ACT OF 2006 (“PPA”): Charitable Provision Highlights

INCENTIVES

1. TAX-FREE DISTRIBUTIONS FROM IRAS TO CHARITY

a. Prior law

Individuals could not make tax-free distributions from their traditional IRAs to charity during their lifetimes. Although funds could be withdrawn from the traditional IRA and then donated to charity, tax law limitations (including limits on itemized deductions) generally prevented the charitable deduction from completely offsetting the income recognized on withdrawal.

b. PPA, adding new IRC section 408(d)(8), effective in 2006 and 2007 only

(1) PPA allows taxpayers over age 70½ to distribute up to $100,000 per year directly to certain charities from their IRA accounts. No income is recognized on the transfer, and no income tax charitable deduction is available. Distributions must be made “directly by the trustee” and will not qualify unless the charity is described in IRC section 170(b)(1)(A), i.e. a charity to which the 50% limitation applies.

(2) Significantly, not every distribution to a charity described in IRC section 170(b)(1)(A) will be a “qualified charitable distribution” under the Act. Specifically excluded are: all donor advised funds, all supporting organizations and most private foundations (other than private operating foundations, as defined in IRC section 4942(j)(3) and certain pass-through foundations).

(3) For Traditional IRAs, the distribution to charity counts towards satisfying the current year’s minimum distribution requirement. In addition, if the owner of a Traditional IRA has made both nondeductible and deductible contributions to the IRA, any direct distributions to charity are treated first as income attributable to deductible contributions and earnings.

c. Client impact

(1) Available only to clients over age 70½ (and for clients who will become over age 70½ in 2006 or 2007). Client must be over age 70½ before the distribution is made.
(2) Clients will need to confirm that the charities they select are eligible to receive “qualified charitable distributions” under the Act. Problem area: many hospitals and educational organizations have established supporting organizations to receive donations; supporting organizations of all types are specifically excluded under the Act.

(3) Clients should consider using Traditional IRA for significant charitable giving in 2006 and 2007. An IRA is a good asset to use for charitable giving because of its built-in income tax liability.

(4) Clients should consider using this provision fully, e.g. accelerating future charitable gifts (including outstanding lifetime pledges to charity) into 2006 and 2007.

2. NEW INCENTIVE FOR QUALIFIED CONSERVATION CONTRIBUTIONS

a. Prior law

Qualified conservation contributions were subject to the same percentage limitations and carryover rules as other charitable contributions of capital gain property, i.e. a 30 percent of gross income limitation and a five-year carryover period rule for purposes of the income tax charitable deduction.

b. PPA, adding new IRC Section 170(b)(1)(E), effective for 2006 and 2007 only

(1) Effective only for 2006 and 2007, qualified conservation contributions are no longer subject either to the 30 percent of gross income limitation or the five-year carryover period rule. Instead, qualified conservation contributions are deductible up to a new 50 percent of gross income limitation, and are allowed a special fifteen year carryover period.

(2) Example: In 2006, Anthony has $200,000 gross income. He makes a qualified conservation contribution of $1 million, as well as cash charitable contributions of $20,000. $80,000 of his qualified conservation contribution is allowed in 2006 ($200,000 x 50%–$20,000). The balance can be carried forward for up to fifteen years.

(3) Even more generous rules apply to farmers or ranchers who make such contributions, including non-publicly traded framing or ranching corporations, creating easements on farming or ranching property that preserve the current use.
c. **Client impact**

Donors who are considering qualified conservation contributions should talk to their tax advisors about making the donation in 2006 or 2007, while the relaxed percentage limitation provisions are in effect.

### 3. ENCOURAGING CHARITABLE CONTRIBUTIONS BY S CORPORATIONS

a. **Prior law**

(1) S corporation shareholders were required to reduce their basis in their S corporation stock by the full fair market value of any charitable contributions of property made by the S corporation.

(2) Example: S corporation with a single shareholder makes a charitable contribution of long-term capital gain property. The property has a fair market value of $50,000 and an adjusted basis of $25,000. The shareholder must reduce his basis in his S corporation stock by $50,000.

b. **PPA, amending IRC section 1367(a)(2), effective for contributions made in taxable years beginning after December 31, 2005 and before January 1, 2008**

(1) While this provision is effective, S corporation shareholders are required to reduce their basis in their S corporation stock by their pro rata share of the adjusted tax basis of property contributed to charity by the S corporation.

(2) Example: S corporation with a single shareholder makes a charitable contribution of long-term capital gain property in its taxable year beginning July 1, 2006. The property has a fair market value of $50,000 and an adjusted basis of $25,000. The shareholder must reduce his basis in his S corporation stock by $25,000.

c. **Client impact**

This time-limited change is favorable to S corporation shareholders since the adjusted basis of contributed property should always be less than its fair market value.
4. REDUCTION OF QUALIFIED CONSERVATION CONTRIBUTION FOR PRIOR REHABILITATION CREDITS RECEIVED

a. Background
A rehabilitation tax credit is available under IRC section 47 for “qualified rehabilitation expenditures.”

b. Prior law
Donors who had been allowed rehabilitation tax credits could claim a full charitable deduction for qualified conservation contributions of the rehabilitated property.

c. PPA, adding new IRC section 170(f)(14), effective for contributions made after August 17, 2006
If the donor has been allowed rehabilitation credits with respect to a building, any qualified conservation contribution of that building will be reduced pro-rata. For this purpose, total rehabilitation tax credits allowed the donor over the past five years are taken into account.

d. Client impact
This provision reduces the economic incentives to rehabilitate and preserve historic buildings.

5. NEW LIMITATIONS ON CONSERVATION EASEMENTS IN REGISTERED HISTORIC DISTRICTS

a. Background
A conservation easement is essentially a contract between the donor and the charitable or governmental recipient that restricts the use of the underlying property for conservation purposes. Once the donor has granted the easement, it is the responsibility of the donee to enforce its terms.

b. Prior law
(1) A charitable deduction was available for “qualified conservation contributions” of historic façade easements, i.e. easements that protect only the front side of an historic building.
(2) There was no requirement that the donee agree to enforce any type of conservation easement.

(3) There was no appraisal requirement unless the value of the “qualified conservation contribution” was $5,000 or more.

c. **PPA adding new IRC sections 170(h)(4)(B) and 170(f)(13)**

(1) New rules now apply to conservation easements relating to the exterior of certain buildings of historic significance located in a registered historic district but not themselves listed in the National Register of Historic Places. *Effective for contributions made after July 25, 2006*, a deduction is not available unless

(a) the easement

   (i) preserves the height of the building—and its exterior on all sides—and

   (ii) prohibits any change in the exterior of the building inconsistent with its historic character; and

(b) the charity that receives the easement certifies, under penalties of perjury, that it has the resources to manage and enforce the easement and “a commitment to do so.”

(2) There are also new appraisal requirements for donors of a conservation easement relating to these buildings—regardless of the amount of the qualified conservation contribution. *Effective for taxable years beginning after August 17, 2006.*

(3) A new $500 filing fee is imposed on contributions of $10,000 or more involving the exterior of these buildings, *effective for contributions made 180 days or more after August 17, 2006.*

d. **Client impact**

The new rules make planning for conservation easements in registered historic districts more challenging for buildings that are not listed in the National Register.

6. **INCREASING PRIVATE FOUNDATION EXCISE TAXES**

a. **Background**

Foundations and their managers are subject to penalty excise taxes if they engage in certain types of prohibited transactions. A less onerous “initial tax” is followed by a crushing “additional” or “second-tier” tax if the forbidden act is not corrected within a reasonable period. Generally speaking, well-managed foundations do not incur these taxes.
b. Prior law

The initial penalty taxes ranged from 2%–15%, with a liability ceiling for foundation managers of $10,000 per violation for both initial and additional taxes.

c. PPA, amending IRC sections 4941–4945, effective for taxable years beginning after August 17, 2006

(1) The initial penalty excise taxes on foundations and their managers are doubled. The ceiling on the amount of first and/or second-tier tax that can be imposed on managers is doubled.

(2) The new rates and ceilings, effective for foundation years beginning after August 17, 2006, are shown below:

<table>
<thead>
<tr>
<th>Prohibited Act</th>
<th>Foundation</th>
<th>Manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-dealing (section 4941)</td>
<td>10% of amount involved</td>
<td>5% of amount involved. Ceiling on liability for both the initial and the additional tax is increased to $20,000 per act.</td>
</tr>
<tr>
<td>Failure to make required charitable distributions (section 4942)</td>
<td>30% of the undistributed amount</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Excess business holdings (section 4943)</td>
<td>10% of the value of the excess holdings</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Jeopardizing investments (section 4944)</td>
<td>10% of the value of the investment</td>
<td>10% of the value of the investment, up to a maximum of $10,000 per investment. (The ceiling for additional tax is increased to $20,000 per investment.)</td>
</tr>
<tr>
<td>Taxable expenditures (section 4945)</td>
<td>20% of the amount of the expenditures</td>
<td>5% of the amount of the expenditure, up to a maximum of $10,000 per expenditure. The ceiling for additional tax is increased to $20,000 per expenditure.)</td>
</tr>
</tbody>
</table>
d. **Client impact**

(1) Proper foundation management, including appropriate conflict of interest and compensation policies become even more important.

(2) The new rules should not adversely affect well-run foundations.

(3) The increased penalty taxes on foundation managers may make outside experts less willing to serve on family foundation boards.

7. **BROADENING THE TAX ON NET INVESTMENT INCOME**

a. **Background**

A two percent excise tax is imposed on the net investment income of a private foundation.

b. **Prior law**

The Code limited net investment income to specific types of income, including interest, dividends, rents—and capital gains from certain income producing property. Due to a conflict between the Code and the regulations, taxpayers and the IRS argued over what types of income are subject to tax.

c. **PPA, amending IRC section 4940(c) and section 509(e), effective for taxable years beginning after August 17, 2006**

The definition of net investment income is broadened to include income and gains similar to that already enumerated in the Code. The Joint Committee on Taxation Explanation clarifies that “capital gains from appreciation” are to be taken into account, “including capital gains and losses from the sale or other disposition of assets used to further an exempt purpose.” J.C.T. Rep. No. JCX-38-06. Comment: the new statutory language leaves much to be desired.

d. **Client impact**

(1) Taxing gain on sale of capital property used for an exempt purpose might leave the foundation with insufficient funds to purchase needed replacement property. PPA addresses this problem by providing a limited like-kind exchange safe harbor.

(2) There is now no doubt that gain on sale of raw land held by a private foundation must be taken into account for purposes of computing the tax on net investment income.
8. NEW LIMITS ON CONTRIBUTIONS OF CLOTHING AND HOUSEHOLD GOODS

a. Prior law
For purposes of computing the income tax charitable deduction, there were no minimum requirements regarding the condition or value of donated clothes or household goods.

b. PPA, adding new IRC section 170(f)(16), effective for contributions made after August 17, 2006 by individuals, corporations and partnerships
A charitable deduction for donations of clothing and household goods is available only for items in “good used condition or better.” In addition, the Treasury is authorized to issue Regulations denying the deduction for items of “minimal monetary value.” The new rules do not apply to donations of food; paintings, antiques and other objects of art; jewelry and guns; and collections. They also do not apply to any single item valued at more than $500, provided the taxpayer provides a qualified appraisal of the property with the relevant tax return.

c. Client impact
(1) It may be difficult for donors and recipient charities to document the condition of donated property.

(2) Unclear whether the new limitations will discourage this type of charitable donation.

9. PENALTIES ARE A GREATER DETERRENT FOR INFLATED APPRAISALS

a. Background
Thanks to some well-publicized abusive transactions, Congress and the IRS share a concern over inflated charitable deductions, particularly for large donations of non-publicly traded property, such as real estate, art or closely-held stock. The fear is that too many large charitable deductions will be based on flawed appraisals that overstate actual value.

b. Prior law
Penalties were imposed for inflated valuations of property: 20 percent (of the resulting underpayment of tax) for a “substantial” overstatement and 40 percent for a “gross” overstatement. However, these penalties did not serve as an effective deterrent because the penalty threshold was too high: a valuation overstatement was “substantial” only if it
overstated actual value by 200 percent or more—and “gross” only if it overstated actual value by 400 percent or more.

c. **PPA, amending IRC section 6662, generally effective for returns filed after August 17, 2006**

(1) The new law lowers the thresholds for inflated valuations, making it more difficult for taxpayers to avoid significant penalties. A valuation overstatement is now “substantial” if it is 150 percent or more of the actual value—and “gross” if 200 percent or more of actual value.

(2) The penalty remains the same: 20 percent of the underpayment for a “substantial” overstatement and 40 percent for a “gross” overstatement.

(3) If the donated property is an easement on the exterior of a building located in a registered historic district and certified by the Secretary of the Interior as being of historic significance, the new rules apply to returns filed after July 25, 2006.

d. **Client impact**

Donors need to exercise caution when valuing charitable donations. There is no substitute for working with a reputable appraiser (see below).

10. **NEW REQUIREMENTS FOR APPRAISERS**

a. **Background**

When individuals, corporations or partnerships gift property valued at $5,000 or more (other than most publicly traded stock), they must obtain a “qualified appraisal” to substantiate the value of their contribution. In order to be a “qualified appraisal,” the appraisal must be performed by a “qualified appraiser.”

b. **Prior law**

It was not difficult to meet the requirements for being a “qualified appraiser.” For example, anyone who performed appraisals on a regular basis would generally qualify under the old rules.

c. **PPA, amending IRC section 170(f)(11)(E), generally effective for returns filed after August 17, 2006**

(1) A “qualified appraiser” must either have earned “an appraisal designation from a recognized professional appraiser organization” or meet minimum education and experience
requirements to be prescribed by future regulations. With respect to any specific appraisal, an appraiser is not treated as “qualified” unless he or she—

(a) “…demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and

(b) “…has not been prohibited from practicing before the IRS at any time during the 3-year period ending on the date of the appraisal.”

(2) If the donated property is an easement on the exterior of a building exterior located in a registered historic district and certified by the Secretary of the Interior as being of historic significance, the new rules apply to appraisals prepared for returns filed after July 25, 2006.

d. Client impact

(1) If the appraiser is not a qualified appraiser, the appraisal will not be a qualified appraisal, and the charitable deduction will be disallowed.

(2) Clients who have already had appraisals prepared for their 2006 Form 1040 should confirm that the appraiser meets the new requirements.

(3) These new rules put a premium on checking out appraiser qualifications carefully.

11. NEW PENALTIES ON APPRAISERS

a. Prior law

Appraisers who prepared inflated valuations were not subject to special penalties.

b. PPA, adding new IRC section 6695A, generally effective for appraisals prepared for returns filed after August 17, 2006

(1) Appraisers who prepare valuations that result in a substantial or gross valuation misstatement are subject to stiff penalties—i.e. the lesser of (a) 10 percent of the understatement (but not less than $1,000) or (b) 125 percent of their appraisal fee.

(2) If the donated property is an easement on the exterior of a building located in a registered historic district and certified by the Secretary of the Interior as being of historic significance, the new rules apply to appraisals prepared for returns filed after July 25, 2006.

c. Client impact

These penalties should serve as a substantial deterrent to inflated appraisals.
12. NEW REPORTING REQUIREMENT FOR SMALL CHARITIES

a. **Prior law**

Small publicly-supported charities (gross receipts less than $25,000) did not have to file tax returns with the IRS.

b. **PPA, amending IRC section 6033(i), effective for annual periods beginning after 2006**

(1) Certain tax exempt organizations that were exempt from filing an information return (gross receipts less than $25,000) must file a new type of electronic notice annually with the IRS. The notice will request basic information about the organization, including name, mailing address, contact person, and “evidence of the continuing basis” for the organization’s exemption from more rigorous filing requirements. Notice is also required when the organization terminates.

(2) The penalty for failing to file this new form is severe: loss of tax-exemption if an organization fails to file for three consecutive years. There is a procedure for reinstatement which, of course, involves still more paperwork.

(3) The new filing requirement does not apply to churches, synagogues, mosques or other religious congregations.

(4) The notice is subject to the disclosure and public inspection rules of IRC section 6104(b).

c. **Client impact**

Small charities may want to adopt new procedures to ensure that the filing requirements are satisfied.

13. NEW SUBSTANTIATION RULES FOR SMALL DONATIONS

a. **Background**

Contributions of $250 or more must be substantiated by the donee organization. The Treasury regulations require that contributions of property valued at less than $250 generally be evidenced by a receipt.

b. **Prior law**

For contributions of money, the taxpayer’s written records were adequate to substantiate donations less than $250.
c. **PPA, adding new IRC section 170(f)(17), effective for contributions made in taxable years beginning after August 17, 2006**

No charitable deduction is allowed for a monetary contribution (whether by cash or by check) unless the donor can produce a bank record or written communication from the donee showing the name of the organization as well as the date and amount of the contribution.

d. **Client impact**

(1) This is a burdensome requirement for any charity that has historically relied on street-corner (or door-to-door) solicitations—or that typically receives a large number of small cash contributions.

(2) Donors who formerly gave cash are now more likely to give by check.

(3) Hopefully, further guidance from the IRS will provide needed clarification. For example, most banks now provide clients with images of their checks: are these “bank records” for purposes of the new rules?

14. **NEW ADVERSE CONSEQUENCES FOR FAILING TO FILE FORMS 990**

a. **Background**

All private foundations and most larger organizations described in section 501(a) are required to file annual information returns, Forms 990-PF and 990, respectively. There are stiff monetary penalties for failing to file a timely return.

b. **Prior law**

The Code did not require that tax-exempt status be revoked if an organization failed to file its returns.

c. **PPA, adding new IRC section 6033(j), effective for annual periods beginning after 2006**

Failure to file a required information return for three consecutive years results in revocation of tax-exempt status. Reinstatement is possible only if the organization files a new application for recognition of tax-exempt status.

d. **Client impact**

(1) Assigning responsibility for filing annual information returns has become even more important.
All officers and board members may want to verify that information returns for their organization are timely filed.

**15. INCREASED PENALTIES FOR EXCESS BENEFITS**

**a. Background**
Existing law imposes penalties on those who misuse public charities for their own economic benefit.

**b. Prior law**
The maximum penalty for participation in an “excess benefits transaction” by a board member or officer of a publicly-supported charity was $10,000 per transaction.

**c. PPA, amending IRC Section 4958(d)(2), effective for taxable years beginning after August 17, 2006**
The maximum penalty for participation by a manager in an excess benefits transaction is increased to $20,000 per transaction.

**d. Client impact**
Strong conflict of interest and compensation policies are generally helpful in avoiding excess benefits issues.

**16. DONOR CERTIFICATION REQUIREMENT FOR CONTRIBUTIONS OF TANGIBLE PERSONAL PROPERTY**

**a. Prior law**
Under the right circumstances, donors could base their charitable deduction for appreciated tangible personal property on fair market value, instead of tax cost. The critical factor was whether the donee used the contributed property in a way related to donee’s charitable purpose. There were no certification requirements, and donors did not lose the benefit of their charitable deduction if the donee subsequently disposed of the contributed property.

**b. PPA, amending IRC sections 170(e)(1)(B) and 6050L(a) and adding new IRC section 170(e)(7), effective for contributions made after September 1, 2006**
(1) Donors may lose at least part of the tax benefit of their claimed income tax charitable deduction if charity disposes of related-use property valued in excess of $5,000 within three years from the date of contribution.
The rules work somewhat differently, depending on whether the disposition occurs in
(a) The year of contribution or
(b) After the year of contribution, but before the end of the three year period beginning on the date of contribution.

In the first situation, the donor’s charitable deduction may be immediately reduced from fair market value to tax cost. In the latter, the donor may recognize ordinary income in the year of disposition. The amount potentially recognized is equal to the excess of the claimed deduction over tax cost as of the date of contribution.

In either situation, however, all tax benefits are preserved if the donee charity certifies that the donated property was in fact used for a related purpose or that the related use became “impossible or infeasible” to implement.

c. **Client impact**

(1) The new rules result in new uncertainty for donors of tangible personal property, increasing the need for carefully drafted contribution agreements.

(2) Form 8282 must now be filed to report the disposition of any property valued in excess of $5,000 (other than publicly-traded securities) within three years of contribution. The Form will be revised to include a new certification section.

**17. NEW PENALTY FOR FRAUDULENTLY IDENTIFYING TANGIBLE PERSONAL PROPERTY AS RELATED USE PROPERTY**

a. **Prior law**

There was no special penalty for fraudulently identifying tangible personal property as related-use property.

b. **PPA, adding new IRC section 6720A, effective for identifications made after August 17, 2006**

A $10,000 penalty is imposed on any person who, having knowledge that property is not intended for a related use, falsely identifies the property as related-use property.

c. **Client impact**

(1) The new $10,000 penalty should deter charities from falsely certifying that property was used—or intended to be used—for a related purpose.
(2) The penalty should also deter donors from claiming fraudulent deductions for so-called “related-use property” on their income tax returns.

18. NEW RESTRICTIONS ON CONTRIBUTIONS OF FRACTIONAL INTERESTS IN TANGIBLE PERSONAL PROPERTY, SUCH AS ART

a. Background

Donors would claim a charitable deduction (based on fair market value) for transfers of undivided interests in tangible personal property (e.g. art) to a related-use charity (e.g. an art museum). Typically, the donor and the donee would share possession of the property, i.e. the donee would use the contributed property for part of each year, after which it would be returned to the donor’s possession. Congress and the IRS became concerned after learning of abusive situations where the charitable donee was never granted possession or control of the “donated” property.

b. Prior law

(1) Successive transfers of fractional interests in the same tangible personal property were valued, for income, gift, and estate tax purposes, at their fair market value as of the transfer date.

(1) There were no recapture or penalty provisions specifically addressing these “shared possession” arrangements for gift or income tax purposes.

c. PPA, adding new IRC sections 170(o), 2055(g) and 2522(e), effective for contributions, bequests and gifts made after August 17, 2006

(1) Successive transfers of fractional interests in the same tangible personal property are valued, for income, gift and estate tax purposes, at the lesser of (i) fair market value as of time of the initial fractional contribution or (ii) fair market value as of the time of the additional contribution.

(2) Failure to meet new requirements will result in the donor not only paying tax on the full amount of the charitable deduction for income and gift tax purposes, but also paying interest and a ten percent penalty tax.

(A) One critical new requirement is that donors contribute their entire interest in the property to their donee within 10 years of the initial contribution—or, if earlier, before [sic] the donor’s death.
(B) A second requirement is that, during the period before receiving the donor’s entire interest in the property, the donee have substantial physical possession of the property and make use of the property in a manner related to its exempt purpose.

d. **Client impact**

(1) The new rules make these contributions less attractive and more burdensome.

(2) It is even more important to rely on expert legal counsel when planning this type of contribution.

### 19. DONOR ADVISED FUND ANTI-ABUSE PROVISIONS

**a. Background**

(1) Most of the nation’s donor advised funds operate for exclusively charitable purposes. Typically, the sponsoring charity screens all grant requests carefully, rejecting any that are inappropriate. Although this is standard practice, there are isolated instances of ill-conceived and abusive donor advised funds. In some heavily promoted schemes, donors were permitted to use fund monies for their own personal benefit, e.g. for personal loans—or for personal items such as motor homes!

(2) A 25% penalty tax is imposed under IRC section 4958 on disqualified persons who receive an “excess benefit” from certain tax-exempt organizations, with a 10% tax on any manager approving such benefits. These provisions do not expressly apply to donor advised funds.

**b. Prior law**

There were no provisions that specifically addressed donor advised fund abuses.

**c. **PPA, adding new IRC sections 4966 and 4967 and amending IRC Section 4958(f)

(1) New IRC section 4966 imposes a 20 percent tax on each “taxable distribution” of a sponsoring organization, with an additional 5 percent tax on any manager who agrees to make a “taxable distribution.” Taxable distribution is defined broadly to include, for example, any distribution from a donor advised fund to a “natural person.” Distributions, other than distributions to the sponsoring organization, another donor advised fund, or a section 170(b)(1)(A) charity (other than a disqualified supporting organization) are “taxable distributions” if expenditure responsibility requirements are not satisfied. **Effective for taxable years beginning after August 17, 2006.**
(2) New IRC section 4967 imposes a 125 percent tax if a donor or donor advisor recommends a distribution from a donor advised fund which results in more than an incidental benefit to the donor, the donor advisor or any related person. A 10 percent tax is imposed on the agreement of any fund manager to the making of such a distribution. **Effective for taxable years beginning after August 17, 2006.**

(3) Existing “excess benefits” penalty taxes applying to disqualified persons and managers of certain tax-exempt organizations are expressly made applicable to persons associated with donor advised funds, including donors, donor advisors and certain related persons. The entire amount of any “grants, loans, compensation or other similar payments to such persons” is treated as an excess benefit subject to penalty tax. **Effective for transactions occurring after August 17, 2006.**

d. **Client impact**

(1) Donor advised funds that, in the past, have reimbursed donors for charitable expenditures (e.g. fundraising) will no longer be able to do so.

(2) The expenditure responsibility requirements will discourage grants to organizations (a) that are supporting organizations or (b) that are not Code section 170(b)(1)(A) organizations, sponsoring organizations or donor advised funds.

(3) The grant approval process for donor advised funds has been made much more complex.

20. **CONTRIBUTIONS TO DONOR ADVISED FUNDS**

**OF INTERESTS IN CLOSELY-HELD CORPORATIONS, OPERATING PARTNERSHIPS AND OTHER BUSINESS ENTERPRISES**

a. **Background**

Private foundations and their managers are subject to penalty excise taxes if they engage in certain types of prohibited transactions. For example, under the “excess business holdings” provisions, penalty tax is imposed for holding more than the permitted (generally 20%, sometimes 35%) in a business enterprise, such as a closely-held corporation or an operating partnership. Foundations that receive contributions of “excess business holdings” may generally avoid penalty tax by disposing of these interests within five years of contribution.

b. **Prior law**

None of the private foundation penalty taxes applied to donor advised funds.
c. **PPA, adding new IRC section 4943(e), effective for taxable years beginning after August 17, 2006**

The excess business holdings penalty tax now applies to donor advised funds as well as private foundations. As a result, a donor advised fund (together with certain related parties) can hold no more than a permitted percentage (generally 20%, sometimes 35%) of a business enterprise such as a corporation or partnership. If an excess business holding is contributed to a donor advised fund, the sponsoring charity can generally avoid tax by disposing of the holding within a five year period.

d. **Client impact**

(1) Donor advised funds that accept contributions of closely-held stock or interests in operating partnerships will need to plan for their timely disposition.

(2) Fewer donor advised funds may accept contributions of interests in business enterprises.

(3) The delayed effective date of this provision may encourage some donors to contribute closely-held stock or partnership interests before the new provisions become effective. As always, donors should work closely with their tax advisers to avoid missteps.

**21. NEW ACKNOWLEDGMENT RULES FOR DONOR ADVISED FUNDS**

a. **Background**

The general rules involving substantiation of gifts of cash or property apply to contributions to donor advised funds. Donor advised funds typically provide appropriate letters to their donors acknowledging any contributions.

b. **Prior law**

There was no requirement that the sponsoring organization affirm its “exclusive legal control over the assets contributed.”

c. **PPA, adding new IRC sections 170(f)(18)(B), 2055(e)(5)(B) and 2522(c)(5)(B), effective for contributions made more than 180 days after August 17, 2006**

For purposes of the income, gift and estate taxes, charitable deductions for contributions to donor advised funds will be denied unless the sponsoring organization’s acknowledgment letter includes language affirming that the sponsoring organization has “exclusive legal control over the assets contributed.”
22. NEW REPORTING RULES FOR SUPPORTING ORGANIZATIONS

a. Prior law

(1) Supporting organizations with gross receipts of not more than $25,000 were not required to file annual information returns.

(2) Supporting organizations were not required to identify themselves as Type I, II or III on their information returns.

b. PPA, amending IRC sections 6033(a)(3)(B) and adding IRC section 6033(l), effective for returns filed for taxable years ending after August 17, 2006

(1) All supporting organizations must file annual information returns, with a special qualifying certification. According to the legislative history, the certification will be designed to ensure that the majority of each supporting organization’s governing board is composed of

   (a) experts “in the particular field or discipline in which the supporting organization is operating” or

   (b) “representatives of the community served by the supported public charities.”

(2) A supporting organization must identify itself, on the information return, as a Type I, II or III supporting organization.

c. Client impact

(1) It is not clear how the certification requirement will apply to supporting organizations with a sole corporate trustee.

(2) Information returns will become a valuable source of information about supporting organizations.

23. NEW RULES FOR TYPE III SUPPORTING ORGANIZATIONS

a. Prior law

Treasury regulations required that Type III supporting organizations be operated “in connection with” their supported organizations, i.e. they were required to be “responsive to” and “significantly involved in the operations of” the supported organization.
b. PPA, adding new IRC section 509(f); PPA section 1241(d)

Type III supporting organizations must comply with more stringent and specific requirements, making it easier for the IRS to monitor compliance.

The new requirements include:

(1) Type III supporting organizations must provide certain information (to be specified in new Treasury regulations) to their supported organizations. IRC section 509(f), effective for tax years beginning after August 17, 2006.

(2) Type III supporting organizations must generally distribute annually a percentage of either income or assets to their supported organizations, all to be specified in new Treasury regulations. PPA section 1241(d).

(3) Type III supporting organizations may not support foreign charities. IRC section 509(f), generally effective on August 17, 2006, with a transition rule for existing relationships.

(4) A trust will no longer qualify as a Type III supporting organization solely because it is a charitable trust under state law and the supported organization, as beneficiary of the trust, has the power to enforce the trust and compel an accounting. PPA section 1241(c), generally effective on August 16, 2007.

c. Client impact

(1) Trustees will need to determine whether trusts that previously qualified as Type III supporting organizations continue to so qualify.

(2) Supporting organizations will need to monitor the progress of the new regulations closely. For example, it is not clear what the distribution requirements will be.

24. PROHIBITION AGAINST CONTINUING DONOR CONTROL

a. Background

An organization controlled by its donor cannot be a qualified supporting organization.

b. Prior law

An organization qualified as a supporting organization even if its donor controlled its supported organization.
c. **PPA, adding IRC section 509(f), effective on August 17, 2006**

An organization will not qualify as Type I or Type III supporting organization if it accepts contributions from persons that directly or indirectly control its supported organization.

d. **Client impact**

This rule impacts subsequent third-party contributions, as well as contributions from the original donor.

### 25. APPLICATION OF EXCESS BUSINESS HOLDINGS PENALTY TAX TO CERTAIN SUPPORTING ORGANIZATIONS

a. **Background**

When closely-held stock is contributed to a private foundation, the charitable deduction is based on tax cost. In contrast, when closely-held stock is contributed to a supporting organization, the charitable deduction is based on fair market value. For this reason, many donors chose to donate their closely held stock to a supporting organization.

b. **Prior law**

The excess business holdings penalty tax did not apply to supporting organizations.

c. **PPA, adding new IRC section 4943(f), generally effective for taxable years beginning after August 17, 2006**

With certain limited exceptions, the excess business holdings penalty tax applies to Type III supporting organizations. It also applies to Type II supporting organizations that accept a contribution from a person that directly or indirectly controls its supported organization. Complex transition rules apply to existing holdings.

d. **Client impact**

Donors and their tax advisors will need to consider the excess business holdings tax rules before funding a supporting organization with interests in a business enterprise.

### 26. SUPPORTING ORGANIZATION ANTI-ABUSE PROVISIONS

a. **Background**

(1.) In the recent past, IRS attention has focused on abusive Type III supporting organizations, typically involving loans from the supporting organization to the donor.
(2) IRC section 4958 imposes a 25% penalty tax on disqualified persons who receive an “excess benefit” from certain tax-exempt organizations, with a 10% tax on any manager approving such benefits. These provisions do not expressly apply to supporting organizations.

b. Prior law

There were no provisions that specifically addressed abusive supporting organizations.

c. PPA, adding new IRC section 4958(f)(1)(D) and 4958(c)(3)

(1) Existing “excess benefits” penalty taxes are expressly made applicable to persons directly or indirectly controlling a supporting organization, effective for transactions occurring after August 17, 2006.

(2) In addition, “grants, loans, compensation or other similar payments to such persons” are expressly made subject to penalty tax. The entire amount of the grant, loan, compensation or similar payment is an excess benefit subject to penalty. Effective for transactions occurring after July 25, 2006.

d. Client impact

The expanded “excess benefits” penalty rules require supporting organizations to structure even routine transactions with great care.
C. ESTATE TAX: REPEAL OR COMPROMISE?

1. REPEAL FAILS

a. Background:
Under current law, the estate tax is scheduled to be repealed, for one year only, in 2010.

Legislative action:
(2) On June 8, 2006, Senate voted down motion to consider H.R. 8, 57-41.

2. COMPROMISE FAILS

a. Background:
The compromise legislation most recently considered in Congress is H.R. 5638. Effective January 1, 2010, H.R. 5638:

(1) would provide a $5 million exemption (indexed for inflation) under the estate, gift and generation-skipping tax.
(2) would impose a two-tiered estate tax:
   – $0-$25 million: rate equal to maximum long-term capital gains rate.
     (Bracket not indexed for inflation.)
   – Over $25 million: rate equal to double the maximum long-term capital gains rate.
     (Bracket not indexed for inflation.)
(3) would provide stepped-up basis at death.
(4) would repeal the state death tax exclusion.
(5) would permit the first spouse to die to elect, on a timely filed Form 706, to transfer any unused exemption amount to the surviving spouse.
b. Legislative action:

(1) On June 22, 2006, the House of Representatives passed H.R. 5638, 269-156.

(2) On July 29, 2006, the House of Representatives passed H.R. 5970, 230-180. H.R. 5970 (nicknamed “the Trifecta”) combined (i) the estate tax compromise of H.R. 5638 with (ii) a minimum wage increase and (iii) two year extension of otherwise expired or expiring provisions, including the research and development credit.

(3) On August 3, the Senate blocked consideration of H.R. 5970, 56-42.

c. Client impact:

Clients who have been waiting for legislative action should wait no longer. Those who have not reviewed their estate plans within the past three years should visit their estate planners.


1. BACKGROUND:

President Bush gave the Panel a mandate to produce a revenue neutral simplification of the U.S. income tax system.

2. EXECUTIVE SUMMARY (Simplified Individual Income Tax Plan):

a. Would abolish alternative minimum tax. Estimated cost: $1.3 trillion over 10 years.

b. Would sharply limit tax benefits of mortgage interest, with five or ten year phase-in. Rationale: “tax code encourages overinvestment in housing at the expense of other productive uses.”

(1) Would convert current itemized deduction for mortgage interest to a limited tax credit, the “Home Credit.” Credit would be available only for interest paid to acquire principal residence.
(2) Limit #1 on proposed Home Credit: maximum principal amount on which interest could be computed would be limited to average home price per county, currently $412,000 in most expensive areas.

(3) Limit #2 on proposed Home Credit: credit could not, in any event, exceed 15% of actual mortgage interest payments.

c. Would eliminate state and local tax deductions.
d. Would simplify tax rates to 15%, 25%, 30% and 33%.
e. Would provide 75% exclusion on capital gains from domestic stock held more than one year. All other capital gains taxed at ordinary income tax rates.
f. Would increase $500,000/$250,000 exclusion for gain on sale of principal residence to $600,000/$300,000 and index annually for inflation. Would require three years of ownership and use during five year look-back period instead of only two years.
g. Would allow shareholders to exclude from income the value of dividends received from corporations that are paid out of profits on which tax is paid in the U.S.
h. Would create a deduction for charitable contributions that exceed one percent of income, available to all taxpayers.

3. LEGISLATIVE ACTION:

No pending legislation incorporating the Panel’s recommendations.

© 2006, Northern Trust Corporation

CONFIDENTIALITY NOTICE: This communication is confidential, may be privileged and is meant only for the intended recipient. If you are not the intended recipient, please notify the sender ASAP and delete this message from your system.

IRS CIRCULAR 230 NOTICE: To the extent that this message or any attachment concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law. For more information about this notice, see http://www.northerntrust.com/circular230.