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## NOT-FOR-PROFIT ORGANIZATIONS AND DONOR PROVISIONS OF THE PENSION PROTECTION ACT OF 2006

BY DONNA F. HARTL

On August 17, 2006, the Pension Protection Act was signed into law. Apart from pension provisions, the Act also included many provisions that affect not-for-profit organizations and donors, many of which are set forth and discussed below.

### I. DONOR ADVISED FUNDS

The IRS is following up on its prior commitment to look harder at donor advised funds. A 20% excise tax is imposed on sponsoring organizations of donor advised funds that make improper distributions and a 5% excise tax on fund managers who agreed to such distributions.

There is also an excise tax on donors, donor advisors and related persons who cause a sponsoring organization to make a distribution from a donor advised fund that results in someone receiving more than an incidental benefit from such transfer.

Excise taxes on transactions which result in excess benefits to disqualified persons are now imposed on donor advised funds.

The excess business holdings limitations imposed on private foundations now apply as well to donor advised funds. Charitable contributions to donor advised funds will not be deductible for charitable contributions or donor advised funds maintained by non-charitable and Type III supporting organizations with an exception for donor advised funds maintained by a functionally integrated Type III supporting organization.

### II. EXCISE TAXES

Excise taxes for self-dealing, excess benefit transactions, failure to distribute income, excess business holdings, jeopardizing investments, and taxable expenditures, have been doubled.

### III. IRS REPORTING REQUIREMENTS

If a not-for-profit organization does not file an IRS Form 990, it will now still be required to register with the IRS annually to provide current contact information and prove qualification for tax-exempt status. This provision is aimed at those organizations that do not meet the thresholds for otherwise filing a Form 990. If the organization does not register for three years, the IRS will consider the exempt status revoked and the nonprofit would have to apply for reinstatement. Religious organizations and churches are not subject to these registration requirements.

The IRS is permitted to disclose information about proposed or completed revocation of a nonprofit's tax-exempt status, and proposed or actual federal tax deficiencies to states attorney generals.

### IV. UNRELATED BUSINESS TAXABLE INCOME (UBTI)

Effective through 2007, rent, royalty, annuity, and interest payments received or accrued by certain exempt parent organizations from taxable controlled subsidiaries will not be treated as UBTI to the extent that they are not treated or classified as excess payments.

### V. CORPORATE-OWNED LIFE INSURANCE (COLI) ARRANGEMENTS

For a business to preserve the tax advantages of corporate owned life insurance, (i) The employee must be (a) an employee at any time during the year prior to the his or her death, or (b) at the time of the COLI issuance, a director or a highly-compensated employee, (ii) prior to the policy issuance of the policy, the business provides written notice to the employee of its intent to insure him or her, the amount, the name of the beneficiary, with disclosure if such beneficiary is the applicable policyholder,

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and the employee must consent to being insured, and (iii) the business must file an annual return with the IRS disclosing the number of insured workers, total amount of insurance, and a representation by the business that it has obtained a written consent from the covered worker, and retention of records to verify compliance by the employer.

Existing plans as of August 17, 2006 are exempt from the new provision.

## VI. CONTRIBUTIONS

### *Cash Contributions*

Charitable contributions of money gifts must now be substantiated with either a bank record, receipt, letter, or other written form of communication indicating the name of the donee organization and the date and amount of the contribution. Otherwise, the money gift will not be deductible.

### *IRA Gift Rollovers*

Effective through 2007, IRA owners 70 ½ years of age or older may distribute tax free up to \$100,000 from an IRA to charitable organizations for which deductible contributions would otherwise be allowed. No charitable deduction will be allowed for such contribution and that distribution will count toward the minimum distribution requirement of the IRA.

### *Clothing and Household Items*

Donors cannot deduct used clothing or household items unless they are in at least good used condition. The IRS has the authority to determine when a contribution has a minimal cash value. A deduction may be allowed for charitable gifts of a single item of clothing or household item not in good condition or better if the amount claimed is more than \$500, and if the taxpayer includes a qualified appraisal with the return. Excluded from the definition of household items are food, paintings, objects of art, jewelry and gems, and collections.

### *S Corporation Stock Basis Adjustment*

Effective for 2006 and 2007, an S corporation shareholder may only reduce basis in S corporation stock equal to the shareholder's pro rata share of the basis (not fair market value) of contributed property.

### *Subsequent Sales of Tangible Gifts*

If a nonprofit that receives certain tangible gifts sells or otherwise disposes of the property within three years of the donation, the nonprofit must file an information return with the IRS. If such gift exceeded \$5000, the deduction must be reduced or recaptured if the nonprofit sells the property within three years

of the contribution. Therefore, the donor must reduce the amount of his deduction exceeding his basis in the property unless the nonprofit certifies its actual use of the tangible property for its charitable purposes prior to the sale or disposition.

### *Fractional Interests in Tangible Property*

The donor must reduce his or her deduction fractional interests of in tangible property if the taxpayer does not contribute its entire interest by the earlier of ten years or at the death of the donor. The charitable deduction is lost if the nonprofit does not have substantial physical possession of the property starting with the initial donation, or if the tangible property is not used for the nonprofit organization's charitable purposes. The tangible property must be owned entirely by the donor, or by the donor and the tax-exempt organization, prior to each fractional gift. The deduction is based on the lesser of the value at the time of the initial gift and the value at the time of each subsequent gift.

### *Conservation Property and Easements Contributions*

A contribution of conservation property must include an easement including a restriction that preserves the entire exterior of the historic building and must also restrict any changes to the exterior that are inconsistent with the building's historical character. Donee organizations must be tax-exempt and have power and authority to impose such restrictions. Donors are required to submit a tax return, qualified appraisal (regardless of value) and photographs of the exterior of the building and a list of all restrictions on the development of the building. A user fee of \$500 is imposed for enforcement of proper conservation contribution deductions claimed in excess of \$10,000.

### *Contribution of Land or Non-Building Structures*

New restrictions are imposed for the charitable donation of land area or non-building structures, which have been declared historic because of a location within a historic district. The structure must be recognized by the National Register or the Secretary of the Interior to the IRS. Accordingly, contributions of personal residences are no longer deductible.

### *Qualified Appraiser*

A qualified appraiser must submit an appraisal in accordance with generally accepted appraisal standards and any regulations or other IRS guidance. A qualified appraiser is an individual who has earned an appraisal designation from a recognized professional organization or has otherwise met minimal education and experience requirements under IRS regulations, regularly performs appraisals for compensation, meets any other requirements as may be described by RS. Appraisers are subject to a penalty equal to the greater of \$1,000 or 10% of the underpayment attributable

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to the valuation misstatement, up to a maximum of 125% of the gross income resulting from preparing the appraisal, in certain circumstances.

#### *Valuation Penalty*

If there is an underpayment of income tax by more than \$5,000 and if the value claimed on the tax return is from 150% to 200% of the correct value, a penalty of 20% of the underpayment of income tax attributable to the overvaluation is imposed. There is a penalty is 40% if the valuation claimed is more than 200% of the correct value. If there is an underpayment of estate or gift tax by more than \$5,000 and if the value claimed on the return is from 65% to 40%, there is a penalty of 20% of the underpayment of estate or gift tax attributable to the undervaluation. There is a 40% penalty if the valuation claimed is 40 % or less of the correct value.

## VII. SUPPORTING ORGANIZATIONS

#### *Excess Business Holdings*

The excess business holdings rule now applies Type III supporting organizations as well.

#### *New Definition and Qualifications*

The new law provides a more detailed definition of supporting organization and creates new requirements for qualification. The new law has a delayed effective date of August 17, 2007 for Type III charitable trusts supporting organizations.

#### *New Restrictions on Excess Benefit Transactions*

Excess benefit transactions will now apply to supporting organizations.

## CITY OF CHICAGO BUSINESS LICENSES

It has recently come to our attention that the City of Chicago is looking for businesses that are operating without the appropriate City license(s) and taking enforcement actions against them. The City of Chicago Municipal Code mandates that no business activity may take place without first obtaining the required license(s). A pending license application does not allow you to operate - you must wait for the license to be issued. If you are doing business in the City of Chicago, the Business Law attorneys at Golan & Christie strongly recommend that you make sure your business is in compliance as soon as possible, rather than waiting until penalties are assessed by the City. The process for obtaining the appropriate license can be completed online at:

<http://egov.cityofchicago.org/city/csbac/home.do>  
by following the Licenses and Taxes wizard.

## EMPLOYMENT LAW ALERT



### NEW RULES FOR CLASSIFYING "INDEPENDENT CONTRACTORS"

On January 1, 2008 the new Employee Classification Act went into effect in Illinois. The Act, which changes the requirements that must be met in order to appropriately classify an individual as an independent contractor, imposes substantial civil and criminal penalties on employers who misclassify their workers.

The Act applies to the construction industry, including public and private construction, residential and commercial building, street, bridge, sewer, water works, railroad and excavation work, as well as maintenance, repair, landscape, decorating work and the moving of construction related materials on the job site to or from the job site. The Act creates a presumption that any individual performing any service for a construction contractor is an employee, unless one of two different several-factor tests is satisfied.

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The Act creates several mechanisms for investigation of potential violations, including what is being referred to as the “bounty hunter” provision which awards 10% of fines collected to any individual who brings complaints to the Department of Labor. If violations are discovered, the Department may assess fines of up to \$1,500 for each individual and for each day, or up to \$2,500 for each repeat violation within a 5 year period. If violations are found to be willful, the penalties may be doubled and the employer will be liable to the employee for punitive damages in an amount equal to the penalties. Two violations within a 5 year period will prevent the employer from being awarded any state contracts.

One way that employers may be able to protect themselves is with carefully drafted independent contractor agreements. The attorneys here at Golan & Christie are available to answer questions or assist in drafting such documents. In our consultation we can work together to determine how to best conform each independent contractor relationship to the new requirements.

Employers with workers who may be covered by the Act are also required to post notices on all job sites. Copies of the required posters, written in English, Spanish, and Polish, are available from the Department of Labor at:

<http://www.state.il.us/Agency/IDOL/FORMS/PDFS/ECA3in1.PDF>



### **AMENDMENT TO ILLINOIS HUMAN RIGHTS ACT ALLOWS FOR STATE COURT LAWSUITS**

A new amendment to the Illinois Human Rights Act will allow individuals filing charges of employment discrimination and harassment under the Act after January 1, 2008 to be able to proceed in state court, rather than being limited to seeking redress before the Department of Human Rights and the Human Rights Commission. Generally, the Act applies to employers with fifteen or more employees. In cases of sexual harassment and disability discrimination, however, the Act covers employers with one or more employees.

Prior to the amendment, if an Illinois employee filed a discrimination charge under the Act, the Department would investigate. If the Department found substantial evidence, it would then file a complaint with the Commission. This administrative process was the exclusive remedy for any violations of the Act. In other words, complainants could not bring their claims of violation of the Act in either state or federal court. This new amendment gives employees the option to pursue those kinds of discrimination claims in a state circuit court.

The result of this new amendment has its consequences: under the prior procedure, complaints were tried in a hearing before an administrative law judge. But in circuit court, either the employee or the employer may demand a jury trial. In addition, depositions typically aren't allowed in the pre-hearing discovery (or fact-finding) process in actions before the Commission. By contrast, parties in circuit court may engage in a full range of discovery, bringing the associated costs along with it. These changes may, depending on the case, change an employer's strategy when responding to a claim under the Act.



### **FMLA AMENDED TO PROVIDE GREATER LEAVE BENEFITS FOR MILITARY SERVICE**

On January 28, 2008, President Bush signed the National Defense Authorization Act into law. Although most of the Act is related to spending on the Iraq war, it also creates additional bases for unpaid leave under the Family and Medical Leave Act (FMLA) related to a family member's service in the armed forces. The amendments increase the scope of the FMLA by allowing for up to 26 weeks of unpaid leave to care for a family member injured as a result of his or her service, and up to 12 weeks of unpaid leave to spend with a family member in the Reserve or National Guard prior to a pending deployment. Interpretive regulations are expected to be issued in the future that will likely provide greater clarity as to the scope and impact of the amendments.



### **HOW DO YOU KNOW WHICH H.R. PRODUCTS TO TRUST?**

There are a wide variety of vendors who offer products designed to assist Human Resource managers in dealing with employee issues, but not all products are equally helpful. Though no product can take the place of competent legal advice, there are some products that will help you to implement the strategies and policies that you have created with your attorneys. The employment lawyers at Golan & Christie frequently review and test the most popular products and services on the market in order to be able to determine whether the information is reliable. We are available to answer questions and help you to evaluate particular vendors or products.





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## VIATICAL AND LIFE SETTLEMENTS: AN ALTERNATIVE USE OF THE LIFE INSURANCE POLICY

Life insurance policies offer financial options for the policyholder. For example, life insurance policies can be used as collateral for loans. They can also be sold for a cash percentage of the policy prior to the policyholder's death. Under the latter scenario, which is known as a “viatical settlement” or “life settlement”, the policyholder may sell his policy to a secondary market just as he would sell a stock or bond. This secondary market gives the policyholder a market that did not exist in the past. In prior years, the policyholder was left with only one entity to deal with—his own insurance carrier. This alternative allows the policyholder to obtain institutional and real market pricing for this valued asset.

In a typical viatical settlement situation, a policyholder contracts to sell the right to claim his life insurance proceeds to a third party. In this transaction, the policyholder will typically receive a lump-sum payment which he can spend without restriction. The third party assumes the premium payments until the policyholder's death. Life settlements are identical to viatical settlements except that they involve a *healthy, elderly* policyholder.

The secondary market for viatical and life settlements allows policyholders to get money that was once only available to their beneficiaries. Previous options, including surrendering the policy and accelerated death benefits, do not provide the immediate financial assistance that people fighting life threatening diseases like cancer get from a viatical settlement.

Viatical and life settlements may provide new opportunities for senior citizens, including a financial tool for estate planning, immediate payment for long-term health care, cash for investment, and enhancing quality of life. For example, a person who is terminally ill and holds a \$100,000 life insurance policy on himself may be able to sell the policy for \$75,000 to a viatical firm, who then becomes the beneficiary of the policy. The policyholder now has the \$75,000 cash to use for whatever purpose he chooses and the viatical firm holds a policy that will eventually pay \$100,000 when the policyholder dies. The amount an investor will pay for the policy depends on a combination of factors, including the policyholder's age and life expectancy. There may be less expensive alternatives for the policyholder, including a settlement directly with the insurance company or a loan using the policy as collateral.

Viatical and life settlement contracts are being sold as securities, and although there is nothing inherently wrong with investing in such settlements, they are relatively new investment vehicles and, as such, are not yet as well regulated as other investments. Investors and policyholders wishing to enter into viatical or life settlement contracts should consult their legal and investment advisers, unaffiliated with the viatical or life settlement provider or the sales agent, regarding tax and other legal and practical implications of investing in a viatical or life settlement contract or selling a life insurance policy.

If you have questions regarding viatical and life settlements, or the use of a life insurance policy as collateral for a loan, please contact Stephen L. Golan.

# OUR FOCUS IS YOU

Putting our clients first is not just a slogan for Golan & Christie. Everything we do stems from your needs, goals and objectives.

From the moment we first meet, we are driven by one thing: your ultimate success. And we go the extra mile to achieve it.

We devote as much time as necessary to get to know you. Only then can we make a thorough assessment of your situation and develop solutions that are the most appropriate for you. As our team goes to work for you, we continue to invest time in listening to, observing and advising you.

In the end, we measure our success by your success.

### TO LEARN MORE...

The employment attorneys at GOLAN & CHRISTIE LLP provide day-to-day employment counseling and dispute-resolution advice on a wide range of issues that face employers.

If you would like additional information, please contact:

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### OUR PRACTICE

Our practice covers many aspects of law and business, with an emphasis on the areas listed below:

- Business Law & Governance
- Commercial & Corporate Litigation
- Commercial Real Estate
- Employment Law
- Estate Planning & Taxation
- Finance
- Reorganization & Bankruptcy

### IN OUR NEXT ISSUE...

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