

Wednesday, July 20, 2011

*GiftLaw Pro*

**Sec. 4943 Taxes on Excess Business Holdings**

**Code Sections**

**(a) INITIAL TAX**

**(b) ADDITIONAL TAX**

**(c) EXCESS BUSINESS HOLDINGS**

**(d) DEFINITIONS; SPECIAL RULES**

**(e) APPLICATION OF TAX TO DONOR ADVISED FUNDS**

**(f) APPLICATION OF TAX TO SUPPORTING ORGANIZATIONS**

**(a) INITIAL TAX**

(1) IMPOSITION

There is hereby imposed on the excess business holdings of any private foundation in a business enterprise during any taxable year which ends during the taxable period a tax equal to 10 percent of the value of such holdings.

(2) SPECIAL RULES

The tax imposed by paragraph (1)--

(A) shall be imposed on the last day of the taxable year, but

(B) with respect to the private foundation's holdings in any business enterprise, shall be determined as of that day during the taxable year when the foundation's excess holdings in such enterprise were the greatest.

**(b) ADDITIONAL TAX**

In any case in which an initial tax is imposed under subsection (a) with respect to the holdings of a private foundation in any business enterprise, if, at the close of the taxable period with respect to such holdings, the foundation still has excess business holdings in such enterprise, there is hereby imposed a tax equal to 200 percent of such excess business holdings.

**(c) EXCESS BUSINESS HOLDINGS**

For purposes of this section--

(1) IN GENERAL

The term "excess business holdings" means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

(2) PERMITTED HOLDINGS IN A CORPORATION

#### (A) IN GENERAL

The permitted holdings of any private foundation in an incorporated business enterprise are--

- (i) 20 percent of the voting stock, reduced by
- (ii) the percentage of the voting stock owned by all disqualified persons.

In any case in which all disqualified persons together do not own more than 20 percent of the voting stock of an incorporated business enterprise, nonvoting stock held by the private foundation shall also be treated as permitted holdings.

#### (B) 35 PERCENT RULE WHERE THIRD PERSON HAS EFFECTIVE CONTROL OF ENTERPRISE

If--

- (i) the private foundation and all disqualified persons together do not own more than 35 percent of the voting stock of an incorporated business enterprise, and
- (ii) it is established to the satisfaction of the Secretary that effective control of the corporation is in one or more persons who are not disqualified persons with respect to the foundation,

then subparagraph (A) shall be applied by substituting 35 percent for 20 percent.

#### (C) 2 PERCENT DE MINIMIS RULE

A private foundation shall not be treated as having excess business holdings in any corporation in which it (together with all other private foundations which are described in section 4946(a)(1)(H)) owns not more than 2 percent of the voting stock and not more than 2 percent in value of all outstanding shares of all classes of stock.

#### (3) PERMITTED HOLDINGS IN PARTNERSHIPS, ETC.

The permitted holdings of a private foundation in any business enterprise which is not incorporated shall be determined under regulations prescribed by the Secretary. Such regulations shall be consistent in principle with paragraphs (2) and (4), except that--

- (A) in the case of a partnership or joint venture, "profits interest" shall be substituted for "voting stock", and "capital interest" shall be substituted for "nonvoting stock",
- (B) in the case of a proprietorship, there shall be no permitted holdings, and
- (C) in any other case, "beneficial interest" shall be substituted for "voting stock".

#### (4) PRESENT HOLDINGS

(A) --

- (i) In applying this section with respect to the holdings of any private foundation in a business enterprise, if such foundation and all disqualified persons together have holdings in such enterprise in excess of 20 percent of the voting stock on May 26, 1969, the percentage of such holdings shall be substituted for "20 percent," and for "35 percent" (if the percentage of such holdings is greater than 35 percent), wherever it appears in paragraph (2), but in no event shall the percentage so substituted be more than 50 percent.

(ii) If the percentage of the holdings of any private foundation and all disqualified persons together in a business enterprise (or if the percentage of the holdings of the private foundation in such enterprise) decreases for any reason, clause (i) and subparagraph (D) shall, except as provided in the next sentence, be applied for all periods after such decrease by substituting such decreased percentage for the percentage held on May 26, 1969, but in no event shall the percentage substituted be less than 20 percent. For purposes of the preceding sentence, any decrease in percentage holdings attributable to issuances of stock (or to issuances of stock coupled with redemptions of stock) shall be disregarded so long as--

(I) the net percentage decrease disregarded under this sentence does not exceed 2 percent, and

(II) the number of shares held by the foundation is not affected by any such issuance or redemption.

(iii) The percentage substituted under clause (i), and any percentage substituted under subparagraph (D), shall be applied both with respect to the voting stock and, separately, with respect to the value of all outstanding shares of all classes of stock.

(iv) In the case of any merger, recapitalization, or other reorganization involving one or more business enterprises, the application of clauses (i), (ii), and (iii) shall be determined under regulations prescribed by the Secretary.

(B) Any interest in a business enterprise which a private foundation holds on May 26, 1969, if the private foundation on such date has excess business holdings, shall (while held by the foundation) be treated as held by a disqualified person (rather than by the private foundation)--

(i) during the 20-year period beginning on such date, if the private foundation and all disqualified persons have more than a 95 percent voting stock interest on such date,

(ii) except as provided in clause (i), during the 15-year period beginning on such date, if the foundation and all disqualified persons have more than a 75 percent voting stock interest (or more than a 75 percent profits or beneficial interest in the case of any unincorporated enterprise) on such date or more than a 75 percent interest in the value of all outstanding shares of all classes of stock (or more than a 75 percent capital interest in the case of a partnership or joint venture) on such date, or

(iii) during the 10-year period beginning on such date, in any other case.

(C) The 20-year, 15-year, and 10-year periods described in subparagraph (B) for the disposition of excess business holdings shall be suspended during the pendency of any judicial proceeding by the private foundation which is necessary to reform, or to excuse such foundation from compliance with, its governing instrument or any other instrument (as in effect on May 26, 1969) in order to allow disposition of such holdings.

(D) --

(i) If, at any time during the second phase, all disqualified persons together have holdings in a business enterprise in excess of 2 percent of the voting stock of such enterprise, then subparagraph (A)(i) shall be applied by substituting for "50 percent" the following: "50 percent, of which not more than 25 percent shall be voting stock held by the private foundation".

(ii) If, immediately before the close of the second phase, clause (i) of this subparagraph

did not apply with respect to a business enterprise, then for all periods after the close of the second phase subparagraph (A)(i) shall be applied by substituting for "50 percent" the following: "35 percent, or if at any time after the close of the second phase all disqualified persons together have had holdings in such enterprise which exceed 2 percent of the voting stock, 35 percent, of which not more than 25 percent shall be voting stock held by the private foundation".

(iii) For purposes of this subparagraph, the term "second phase" means the 15-year period immediately following the 20-year, 15-year, or 10-year period described in subparagraph (B), whichever applies, as modified by subparagraph (C).

(E) Clause (ii) of subparagraph (B) shall not apply with respect to any business enterprise if before January 1, 1971, one or more individuals who are substantial contributors (or members of the family (within the meaning of section 4946(d)) of one or more substantial contributors) to the private foundation and who on May 26, 1969, held more than 15 percent of the voting stock of the enterprise elect, in such manner as the Secretary may by regulations prescribe, not to have such clause (ii) apply with respect to such enterprise.

#### (5) HOLDINGS ACQUIRED BY TRUST OR WILL

Paragraph (4) (other than subparagraph (B)(i)) shall apply to any interest in a business enterprise which a private foundation acquires under the terms of a trust which was irrevocable on May 26, 1969, or under the terms of a will executed on or before such date, which are in effect on such date and at all times thereafter, as if such interest were held on May 26, 1969, except that the 15-year and 10-year periods prescribed in clauses (ii) and (iii) of paragraph (4)(B) shall commence with respect to such interest on the date of distribution under the trust or will in lieu of May 26, 1969.

#### (6) 5-YEAR PERIOD TO DISPOSE OF GIFTS, BEQUESTS, ETC.

Except as provided in paragraph (5), if, after May 26, 1969, there is a change in the holdings in a business enterprise (other than by purchase by the private foundation or by a disqualified person) which causes the private foundation to have--

(A) excess business holdings in such enterprise, the interest of the foundation in such enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person (rather than by the foundation) during the 5-year period beginning on the date of such change in holdings; or

(B) an increase in excess business holdings in such enterprise (determined without regard to subparagraph (A)), subparagraph (A) shall apply, except that the excess holdings immediately preceding the increase therein shall not be treated, solely because of such increase, as held by a disqualified person (rather than by the foundation).

In any case where an acquisition by a disqualified person would result in a substitution under clause (i) or (ii) of subparagraph (D) of paragraph (4), the preceding sentence shall be applied with respect to such acquisition as if it did not contain the phrase "or by a disqualified person" in the material preceding subparagraph (A).

#### (7) 5-YEAR EXTENSION OF PERIOD TO DISPOSE OF CERTAIN LARGE GIFTS AND BEQUESTS

The Secretary may extend for an additional 5-year period the period under paragraph (6) for disposing of excess business holdings in the case of an unusually large gift or bequest of diverse business holdings or holdings with complex corporate structures if--

(A) the foundation establishes that--

(i) diligent efforts to dispose of such holdings have been made within the initial 5-year period, and

(ii) disposition within the initial 5-year period has not been possible (except at a price substantially below fair market value) by reason of such size and complexity or diversity of such holdings,

(B) before the close of the initial 5-year period--

(i) the private foundation submits to the Secretary a plan for disposing of all of the excess business holdings involved in the extension, and

(ii) the private foundation submits the plan described in clause (i) to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation's disposition of the excess business holdings involved and submits to the Secretary any response received by the private foundation from the Attorney General (or other appropriate State official) to such plan during such 5-year period, and

(C) the Secretary determines that such plan can reasonably be expected to be carried out before the close of the extension period.

#### **(d) DEFINITIONS; SPECIAL RULES**

For purposes of this section--

##### **(1) BUSINESS HOLDINGS**

In computing the holdings of a private foundation, or a disqualified person (as defined in section 4946) with respect thereto, in any business enterprise, any stock or other interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. The preceding sentence shall not apply with respect to an income or remainder interest of a private foundation in a trust described in section 4947(a)(2), but only if, in the case of property transferred in trust after May 26, 1969, such foundation holds only an income interest or only a remainder interest in such trust.

##### **(2) TAXABLE PERIOD**

The term "taxable period" means, with respect to any excess business holdings of a private foundation in a business enterprise, the period beginning on the first day on which there are excess holdings and ending on the earlier of--

(A) the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212 in respect of such holdings, or

(B) the date on which the tax imposed by subsection (a) in respect of such holdings is assessed.

##### **(3) BUSINESS ENTERPRISE**

The term "business enterprise" does not include--

(A) a functionally related business (as defined in section 4942(j)(4)), or

(B) a trade or business at least 95 percent of the gross income of which is derived from passive sources.

For purposes of subparagraph (B), gross income from passive sources includes the items excluded by section 512(b)(1), (2), (3), and (5), and income from the sale of goods (including charges or costs passed on at cost to purchasers of such goods or income received in settlement of a dispute concerning or in lieu of the exercise of the right to sell such goods) if the seller does not manufacture, produce, physically receive or deliver, negotiate sales of, or maintain inventories in such goods.

#### (4) DISQUALIFIED PERSON

The term "disqualified person" (as defined in section 4946(a)) does not include a plan described in section 4975(e)(7) with respect to the holdings of a private foundation described in paragraphs (4) and (5) of subsection (c).

### **(e) APPLICATION OF TAX TO DONOR ADVISED FUNDS**

#### (1) IN GENERAL

For purposes of this section, a donor advised fund (as defined in section 4966(d)(2)) shall be treated as a private foundation.

#### (2) DISQUALIFIED PERSON

In applying this section to any donor advised fund (as so defined), the term "disqualified person" means, with respect to the donor advised fund, any person who is --

(A) described in section 4966(d)(2)(A)(iii),

(B) a member of the family of an individual described in subparagraph (A), or

(C) a 35-percent controlled entity (as defined in section 4958(f)(3) by substituting "persons described in subparagraph (A) or (B) of section 4943(e)(2)" for "persons described in subparagraph (A) or (B) of paragraph (1)" in subparagraph (A)(i) thereof).

#### (3) PRESENT HOLDINGS

For purposes of this subsection, rules similar to the rules of paragraphs (4), (5), and (6) of subsection (c) shall apply to donor advised funds (as so defined), except that --

(A) "the date of the enactment of this subsection" shall be substituted for "May 26, 1969" each place it appears in paragraphs (4), (5), and (6), and

(B) "January 1, 2007" shall be substituted for "January 1, 1970" in paragraph (4)(E).

### **(f) APPLICATION OF TAX TO SUPPORTING ORGANIZATIONS**

#### (1) IN GENERAL

For purposes of this section, an organization which is described in paragraph (3) shall be treated as a private foundation.

#### (2) EXCEPTION

The Secretary may exempt the excess business holdings of any organization from the application of this subsection if the Secretary determines that such holdings are consistent with the purpose or function constituting the basis for its exemption under section 501.

#### (3) ORGANIZATIONS DESCRIBED

An organization is described in this paragraph if such organization is--

(A) a type III supporting organization (other than a functionally integrated type III supporting organization), or

(B) an organization which meets the requirements of subparagraphs (A) and (C) of section 509(a)(3) and which is supervised or controlled in connection with one or more organizations described in paragraph (1) or (2) of section 509(a), but only if such organization accepts any gift or contribution from any person described in section 509(f)(2)(B).

#### (4) DISQUALIFIED PERSON

##### (A) IN GENERAL

In applying this section to any organization described in paragraph (3), the term "disqualified person" means, with respect to the organization--

(i) any person who was, at any time during the 5-year period ending on the date described in subsection (a)(2)(A), in a position to exercise substantial influence over the affairs of the organization,

(ii) any member of the family (determined under section 4958(f)(4)) of an individual described in clause (i),

(iii) any 35-percent controlled entity (as defined in section 4958(f)(3) by substituting "persons described in clause (i) or (ii) of section 4943(f)(4)(A)" for "persons described in subparagraph (A) or (B) of paragraph (1)" in subparagraph (A)(i) thereof),

(iv) any person described in section 4958(c)(3)(B), and

(v) any organization--

(I) which is effectively controlled (directly or indirectly) by the same person or persons who control the organization in question, or

(II) substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in subparagraph (B) or a member of the family (within the meaning of section 4946(d)) of such a person.

##### (B) PERSONS DESCRIBED

A person is described in this subparagraph if such person is--

(i) a substantial contributor to the organization (as defined in section 4958(c)(3)(C)),

(ii) an officer, director, or trustee of the organization (or an individual having powers or responsibilities similar to those of the officers, directors, or trustees of the organization), or

(iii) an owner of more than 20 percent of--

(I) the total combined voting power of a corporation,

(II) the profits interest of a partnership, or

(III) the beneficial interest of a trust or unincorporated enterprise,

which is a substantial contributor (as so defined) to the organization.

**(5) TYPE III SUPPORTING ORGANIZATION; FUNCTIONALLY INTEGRATED TYPE III SUPPORTING ORGANIZATION**

For purposes of this subsection--

(A) **TYPE III SUPPORTING ORGANIZATION** The term "type III supporting organization" means an organization which meets the requirements of subparagraphs (A) and (C) of section 509(a)(3) and which is operated in connection with one or more organizations described in paragraph (1) or (2) of section 509(a).

(B) **FUNCTIONALLY INTEGRATED TYPE III SUPPORTING ORGANIZATION** The term "functionally integrated type III supporting organization" means a type III supporting organization which is not required under regulations established by the Secretary to make payments to supported organizations (as defined under section 509(f)(3)) due to the activities of the organization related to performing the functions of, or carrying out the purposes of, such supported organizations.

**(6) SPECIAL RULE FOR CERTAIN HOLDINGS OF TYPE III SUPPORTING ORGANIZATIONS**

For purposes of this subsection, the term "excess business holdings" shall not include any holdings of a type III supporting organization in any business enterprise if, as of November 18, 2005, the holdings were held (and at all times thereafter, are held) for the benefit of the community pursuant to the direction of a State attorney general or a State official with jurisdiction over such organization.

**(7) PRESENT HOLDINGS**

For purposes of this subsection, rules similar to the rules of paragraphs (4), (5), and (6) of subsection (c) shall apply to organizations described in section 509(a)(3), except that--

(A) "the date of the enactment of this subsection" shall be substituted for "May 26, 1969" each place it appears in paragraphs (4), (5), and (6), and

(B) "January 1, 2007" shall be substituted for "January 1, 1970" in paragraph (4)(E).

[Aug. 7, 2006]



© Copyright 1999-2011 Crescendo Interactive, Inc.