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NOT-FOR-PROFIT ORGANIZATIONS

NEW EXCEPTION TO EXCESS BUSINESS HOLDINGS RULE SIGNED INTO LAW

Last month, President Trump signed into law the Bipartisan Budget Act of 2018 which contains a new exception to the “excess business holdings” rules governing private foundations.

Background

Section 4943 of the Internal Revenue Code imposes excise taxes on the excess business holdings of private foundations. Generally speaking, a private foundation and its disqualified persons (*i.e.*, substantial contributors to the private foundation, directors or officers of the private foundation, etc.) may not, in the aggregate, hold more than 20% of the voting stock or profits interest in a business enterprise. A number of exceptions and special rules apply.

New Exception

The new law has created an important new exception to the excess business holdings rules permitting foundations to own certain philanthropic enterprises. To fall within the new exception, the foundation must hold 100% of the voting stock of the business enterprise and must have received its interest in the enterprise by means other than purchase (*i.e.*, gift, bequest, etc.). Additionally, (i) the business enterprise must distribute its net operating income to the foundation each year; (ii) no substantial contributor to the foundation, or a family member thereof, may be a director, officer, trustee, manager, employee, or contractor of the business enterprise; (iii) at least a majority of the board of the foundation must be made up of persons who are not directors or officers of the business enterprise *or* family members of substantial contributors to the foundation; and (iv) certain types of loans may not be outstanding.

Impact

The new exception appears to have been introduced for the specific purpose of remedying the situation well-known company Newman’s Own found itself in after its founder, Paul Newman, left 100% of the company to the Newman’s Own Foundation upon his death. However, given the increasing interest in philanthropic enterprises of all types, it may have broader implications for donors that seek to place formerly for-profit activities under charitable ownership. Careful planning will be necessary to ensure that specific provisions can be satisfied, and they may not represent the desired approach in every case. In the right situation, however, the new exception opens a new world of possibility for donors that wish to have their business operate for purely charitable aims in a private foundation structure.

If you have questions about this new exception contact any member of the Not-for-Profit practice group at (585) 232-6500 or visit www.hselaw.com.

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