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Newman's Own Foundation Pushes Through Exception to Private Foundation Excess Business Holding Rules

President Donald Trump signed into law Feb. 9 the Philanthropic Enterprise Act as part of the [Bipartisan Budget Act of 2018](#). The new law creates Section 4943(g) of the Internal Revenue Code, which allows private foundations to wholly own a for-profit business as long as the profits are dedicated to charity and the business meets certain governance conditions.

This new statutory exception was championed by Newman's Own Foundation, which has been advocating for years to avoid the imposition of the 200 percent excise tax on a private foundation's "excess business holdings." This change is also a planning opportunity for any foundation that receives ownership interests in a business by gift or bequest, or for donors who utilize "loan out" corporations during their lifetimes. The new exception may also inspire socially conscious businesses to consider new structures to further their founders' philanthropy.

Background

Generally, Section 4943 of the IRS Code prohibits a private foundation and its "disqualified persons" from owning, in the aggregate, more than 20 percent of the voting shares of an active trade or business. "Disqualified persons" include a foundation's substantial contributors, directors and officers, and their family members. If a private foundation does not dispose of its excess business holdings, an initial tax is imposed equal to 10 percent of the value of the excess business holdings during the taxable year. If the situation remains

uncorrected, a second-tier tax equal to 200 percent of the excess business holdings will be imposed.

Under a special rule for gifts and bequests, a private foundation has five years from the date it receives the ownership shares to dispose of its excess business holdings. The IRS may approve a five-year extension of that period if a gift or bequest involves diverse, large or complex business holdings.

The Newman's Own Foundation, which owns 100 percent of No Limit LLC, the for-profit company that produces and sells the Newman's Own-branded line of food products, championed the newly enacted exception to the excess business holdings rule. The foundation received its ownership shares of No Limit LLC by bequest when Paul Newman died. In 2018, at the expiration of the five-year extension the IRS granted in 2013, Newman's Own Foundation faced a mandate to divest at least 80 percent of its ownership of No Limit LLC, absent a specific statutory exception.

Drafts of both the House and Senate versions of the tax reform legislation contained what became known as the "Newman's Own Foundation" proposal, but it did not survive in the final legislation that passed in December. Two months later, the proposal resurfaced in the president's proposed budget, and it has now been enacted as part of the Bipartisan Budget Act of 2018.

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New Rule

The new exception is effective for taxable years beginning after Dec. 31, 2017, and applies in a narrow set of circumstances. A foundation will not have an excess business holding subject to the Section 4943 excise tax if the following are met:

1. The foundation's interest was acquired by means "other than by purchase" (i.e., by gift or bequest).
2. The foundation owns 100 percent of the business's voting stock.
3. All of the business's net operating income is distributed to the foundation within 120 days of the end of the tax year.
4. No substantial contributor to the foundation (or any of his or her family members) is a director, officer, trustee, manager, employee or contractor of the wholly owned business.
5. At least a majority of the foundation's board are persons who are not (1) directors or officers of the business or (2) family members of a substantial contributor.
6. No loan is outstanding from the business to a substantial contributor or his or her family members.

This exception does not apply to certain kinds of entities that are deemed to be or are treated like private foundations. Specifically, the new Section 4943(g) exception does not apply to:

- A fund or organization treated as a private foundation pursuant to Section 4943(e) because it is a donor-advised fund
- A fund or organization treated as a private foundation pursuant to Section 4943(f) because it is a Type III supporting organization.
- Charitable trusts and split-interest trusts subject to the private foundation rules pursuant to Section 4947.

This new exception is narrow and will be useful in only very limited circumstances. However, it presents an important planning opportunity for artists and other philanthropists who utilize loan-out corporations to provide personal services during their lifetimes. Often, the assets of those loan-out corporations are entirely passive income streams, but the IRS has refused to rule that a private foundation can continue to own a decedent's loan-out corporation without running afoul of Section 4943. This change in the law solves this problem.

If you are interested in learning how these rules might affect your private foundation or your philanthropy, please feel free to call any of the attorneys in our [Nonprofits and Tax-Exempt Organizations practice](#) listed below.

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