

(i) The act or failure to act that resulted in the organization's inability to satisfy the requirements of §§ 53.4942(b)-1 and 53.4942(b)-2, and the grantor or contributor was responsible for, or was aware of, such act or failure to act, or

(ii) The grantor or contributor acquired knowledge that the Commissioner has given notice to such organization that it would be deleted from classification as an operating foundation.

(2) *Exception.* For purposes of subparagraph (1) (i) of this paragraph, a grantor or contributor will not be considered to be responsible for, or aware of, the act or failure to act that resulted in the grantee organization's inability to satisfy the requirements of §§ 53.4942(b)-1 and 53.4942(b)-2 if such grantor or contributor has made his grant or contribution in reliance upon a written statement by the grantee organization that such grant or contribution would not result in the inability of such grantee organization to qualify as an operating foundation. Such a statement must be signed by a foundation manager (as defined in section 4946(b)) of the grantee organization and must set forth sufficient facts concerning the operations and support of such grantee organization to assure a reasonably prudent man that his grant or contribution will not result in the grantee organization's inability to qualify as an operating foundation.

Subpart D—Taxes on Excess Business Holdings

AUTHORITY: Secs. 4943 and 7805, Internal Revenue Code of 1954, 68A Stat. 917, 83 Stat. 507; 26 U.S.C. 4943, 7805.

SOURCE: T.D. 7496, 42 FR 46285, Sept. 15, 1977, unless otherwise noted.

§ 53.4943-1 General rule; purpose.

Generally, under section 4943, the combined holdings of a private foundation and all disqualified persons (as defined in section 4946(a)) in any corporation conducting a business which is not substantially related (aside from the need of the foundation for income or funds or the use it makes of the profits derived) to the exempt purposes of the foundation are limited to 20 percent of

the voting stock in such corporation. In addition, the combined holdings of a private foundation and all disqualified persons in any unincorporated business (other than a sole proprietorship) which is not substantially related (aside from the need of the foundation for income or funds or the use it makes of the profits derived) to the exempt purposes of such foundation are limited to 20 percent of the beneficial or profits interest in such business. In the case of a sole proprietorship which is not substantially related (within the meaning of the preceding sentence), section 4943 provides that a private foundation shall have no permitted holdings. These general provisions are subject to a number of exceptions and special provisions which will be described in following sections.

§ 53.4943-2 Imposition of tax on excess business holdings of private foundations.

(a) *Imposition of initial tax—*(1) *In general—*(i) *Initial tax.* Section 4943(a)(1) imposes an initial excise tax (the "initial tax") on the excess business holdings of a private foundation for each taxable year of the foundation which ends during the taxable period defined in section 4943(d)(2). The amount of such tax is equal to 5 percent of the total value of all the private foundation's excess business holdings in each of its business enterprises. In determining the value of the excess business holdings of the foundation subject to tax under section 4943, the rules set forth in §§ 20.2031-1 through 20.2031-3 of this chapter (Estate Tax Regulations) shall apply.

(ii) *Disposition of certain excess business holdings within ninety days.* In any case in which a private foundation acquires excess business holdings, other than as a result of a purchase by the foundation, the foundation shall not be subject to the taxes imposed by section 4943, but only if it disposes of an amount of its holdings so that it no longer has such excess business holdings within 90 days from the date on which it knows, or has reason to know, of the event which caused it to have such excess business holdings. Similarly, a private foundation shall not be subject to the taxes imposed by section

4943 because of its purchase of holdings where it did not know, or have reason to know of prior acquisitions by disqualified persons, but only if the foundation disposes of its excess holdings within the 90-day period described previously, and its purchase would not have created excess business holding but for such prior acquisitions by disqualified persons. In determining whether for purposes of this (ii) the foundation has disposed of such excess business holdings during such 90-day period, any disposition of holdings, by a disqualified person during such period shall be disregarded.

(iii) *Extension of ninety day period.* The period described in paragraph (a)(1)(ii) of this section, during which no tax shall be imposed under section 4943, shall be extended to include the period during which a foundation is prevented by federal or state securities laws from disposing of such excess business holdings.

(iv) *Effect of disposition subject to material restrictions.* If a private foundation disposes of an interest in a business enterprise but imposes any material restrictions or conditions that prevent the transferee from freely and effectively using or disposing of the transferred interest, then the transferor foundation will be treated as owning such interest until all such restrictions or conditions are eliminated (regardless of whether the transferee is treated for other purposes of the Code as owning such interest from the date of the transfer). However, a restriction or condition imposed in compliance with federal or state securities laws, or in accordance with the terms or conditions of the gift or bequest through which such interest was acquired by the foundation, shall not be considered a material restriction or condition imposed by a private foundation.

(v) *Foundation knowledge of acquisitions made by disqualified persons.* (A) For purposes of paragraph (a)(1)(ii) of this section, whether a private foundation will be treated as knowing, or having reason to know, of the acquisition of holdings by a disqualified person will depend on the facts and circumstances of each case. Factors which will be considered relevant to a determination that a private foundation did

not know or had no reason to know of an acquisition are: the fact that it did not discover acquisitions made by disqualified persons through the use of procedures reasonably calculated to discover such holdings; the diversity of foundation holdings; and the existence of large numbers of disqualified persons who have little or no contact with the foundation or its managers.

(B) The provisions of paragraph (a)(1)(v)(A) of this section may be illustrated by the following example:

Example. By the fifteenth day of the fifth month after the close of each taxable year, the F Foundation sends to each foundation manager, substantial contributor, person holding more than a 20% interest (as described in section 4946(a)(1)(C) in a substantial contributor, and foundation described in section 4946(a)(1)(H), a questionnaire asking such persons to list all holdings, actual or constructive, in each business enterprise in which F had holdings during the taxable year in excess of those permitted by the 2 percent de minimis rule of section 4943(c)(2)(C). In preparing the list of such enterprises, F takes into account its constructive holdings only if, during the taxable year, F (along with all related foundations described in section 4946(a)(1)(H)) owned over 2% of the voting stock, profits interest or beneficial interest in the entity actually owning the holdings constructively held by F. The questionnaire asks each such person to list the holdings in such enterprises of any persons who, because of their relationship to such disqualified person, were themselves disqualified persons (*i.e.*, members of the family (as defined in section 4946(d)), and any corporations, partnerships, trusts and estates described in section 4946(a)(1)(E) through (G) in which such person, or members of his family, had an interest). The questionnaire asks that constructive holdings be listed only if, during the taxable year, the disqualified person owned over 2% of the voting stock, profits interest or beneficial interest in the entity actually owning the holdings constructively held by such person. (Thus a disqualified person owning less than 2% of a mutual fund is not required to list his attributed share of all the securities in the portfolio of the fund.) If no response to the questionnaire is received, the foundation seeks the information requested by the questionnaire by mailing a second (but not a third) questionnaire. If a questionnaire which is returned to the foundation indicates that certain information was unavailable to the person completing the questionnaire, the foundation seeks that information directly. For example, if a disqualified person indicates that he could not find out whether a

corporation described in section 4946(a)(1)(E) had holdings in the enterprise listed in the questionnaire, the foundation seeks to obtain this information directly from the corporation by mailing it a questionnaire. In such a case F may be found not to have reason to know of the acquisition of holdings by a disqualified person.

(vi) *Holdings acquired other than by purchases.* See section 4943(c)(6) and §53.4943-6 for rules relating to the acquisition of certain holdings other than by purchase by the foundation or a disqualified person.

(2) *Special rules.* In applying subparagraph (1) of this paragraph, the tax imposed by section 4943(a)(1):

(i) Shall be imposed on the last day of the private foundation's taxable year, but

(ii) The amount of such tax and the value of the excess business holdings subject to such tax shall be determined with respect to the foundation's holdings (based upon voting power, profits or beneficial interest, or value, whichever is applicable) in any business enterprise as of that day during the foundation's taxable year when the foundation's excess holdings in such enterprise were the greatest.

In applying subdivision (ii) of this subparagraph, if a foundation's excess business holdings in a business enterprise which constitute such foundation's greatest excess holdings in such enterprise for any taxable year are maintained for 2 or more days during such taxable year, the value of such excess holdings which is subject to tax under section 4943(a)(1) shall be the greatest value of such excess holdings in such enterprise as of any day on which such greatest excess holdings are maintained during such taxable year.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). Y is a private foundation reporting on a calendar year basis. On January 1, 1973, Y has 20 shares of common stock in corporation N, of which five shares constitute excess business holdings. On June 1, 1973, Y disposes of such five shares; however, because of additional acquisitions of N common stock on such date by disqualified persons with respect to Y, the remaining 15 shares of N common stock held by Y now constitute excess business holdings. There are no further acquisitions or dispositions of

N common stock during 1973 by Y or its disqualified persons. Although Y's greatest holdings in N during 1973 are held between January 1, 1973, and May 31, 1973, Y's greatest excess holdings in N during 1973 are held between June 1, 1973, and December 31, 1973. Therefore, the tax specified in section 4943(a)(1) shall be computed on the basis of the greatest value of such greatest excess holdings as of any day between June 1 and December 31, 1973.

Example (2). X is a private foundation reporting on a calendar year basis. On January 1, 1972, X has 100 shares of common stock in M corporation which are excess business holdings. On such date each share of M common stock has a fair market value of \$100. On February 28, 1972, in an effort to dispose of such excess business holdings, X sells 70 shares of M common stock for \$120 per share (the fair market value of each share on such date) to A, an individual who is not a disqualified person within the meaning of section 4946(a). The value of \$120 per share is the highest fair market value between January 1 and February 28, 1972. X disposes of no more stock in M for the remainder of calendar year 1972. On December 31, 1972, the fair market value of each share of M common stock is \$80. X calculates its tax on its excess business holdings in M for 1972 as follows:

100 shares of M common stock times \$120 fair market value per share as of Feb. 28, 1972 ...	\$12,000
\$12,000 multiplied by rate of tax (percent)	5
Amount of tax on X foundation's excess business holdings for 1972	\$600

Example (3). Assume the same facts as in Example (2) except that the sale of X to A occurs on January 7, 1973, when the fair market value of each share of M corporation common stock equals \$70. A value of \$100 per share is the highest fair market value of the M common stock between January 1 and January 7, 1973. On May 9, 1973, X for the first time has excess business holdings in N corporation in the form of 200 shares of N common stock. The value per share of N common stock on May 9, 1973, equals \$200. X makes no disposition of the N common stock during 1973, and the value of each share of N common stock as of December 31, 1973 equals \$250 (the highest value of N common stock during 1973). X calculates its tax on its excess business holdings in both M and N for 1973 as follows:

100 shares of M common stock times \$100 fair market value per share	\$10,000
\$250 fair market value per share	\$50,000
Total	\$60,000
Total	\$60,000
\$60,000 multiplied by rate of tax (percent)	5
Amount of tax on X foundation's excess business holdings for 1973	\$3,000

(b) *Additional tax.* In any case in which the initial tax is imposed under

section 4943(a) with respect to the holdings of a private foundation in any business enterprise, if, at the close of the taxable period (as defined in section 4943(d)(2) and § 53.4943-9) with respect to such holdings the foundation still has excess business holdings in such enterprise, there is imposed a tax under section 4943(b) equal to 200 percent of the value of such excess holdings as of the last day of the taxable period.

[T.D. 7496, 42 FR 46285, Sept. 15, 1977, as amended by T.D. 8084, 51 FR 16302, May 2, 1986]

§ 53.4943-3 Determination of excess business holdings.

(a) *Excess business holdings*—(1) *In general.* For purposes of section 4943, the term “excess business holdings” means, with respect to the holdings of any private foundation in any business enterprise (as described in section 4943(d)(4)), the amount of stock or other interest in the enterprise which, except as provided in § 53.4943-2(a)(1), the foundation, or a disqualified person, would have to dispose of, or cause the disposition of, to a person other than a disqualified person (as defined in section 4946(a)) in order for the remaining holdings of the foundation in such enterprise to be permitted holdings (as defined in paragraphs (b) and (c) of this section). If a private foundation is required by section 4943 and the regulations thereunder to dispose of certain shares of a class of stock in a particular period of time and other shares of the same class of stock in a shorter period of time, any stock disposed of shall be charged first against those dispositions which must be made in such shorter period.

(2) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. Corporation X has outstanding 100 shares of voting stock, with each share entitling the holder thereof to one vote. F, a private foundation, possesses 20 shares of X voting stock representing 20 percent of the voting power in X. Assume that the permitted holdings of F in X under paragraph (b)(1) of this section are 11 percent of the voting stock in X. F, therefore, possesses voting stock in X representing a percentage of voting stock in excess of the percentage permitted by such paragraph. Such excess per-

centage is 9 percent of the voting stock in X, determined by subtracting the percentage of voting stock representing the permitted holdings of F in X (*i.e.*, 11 percent) from the percentage of voting stock held by F in X (*i.e.*, 20 percent). (20%–11%=9%). The excess business holdings of F in X are an amount of voting stock representing such excess percentage, or 9 shares of X voting stock (9 percent of 100).

(b) *Permitted holdings in an incorporated business enterprise*—(1) *In general*—(i) *Permitted holdings defined.* Except as otherwise provided in section 4943(c) (2) and (4), the permitted holdings of any private foundation in an incorporated business enterprise (including a real estate investment trust, as defined in section 856) are:

(A) 20 percent of the voting stock in such enterprise reduced (but not below zero) by

(B) The percentage of voting stock in such enterprise actually or constructively owned by all disqualified persons.

(ii) *Voting stock.* For purposes of this section, the percentage of voting stock held by any person in a corporation is normally determined by reference to the power of stock to vote for the election of directors, with treasury stock and stock which is authorized but unissued being disregarded. Thus, for example, if a private foundation holds 20 percent of the shares of one class of stock in a corporation, which class is entitled to elect three directors, and such foundation holds no stock in the other class of stock, which is entitled to elect five directors, such foundation shall be treated as holding 7.5 percent of the voting stock because the class of stock it holds has 37.5 percent of such voting power, by reason of being able to elect three of the eight directors, and the foundation holds one-fifth of the shares of such class (20 percent of 37.5 percent is 7.5 percent). The fact that extraordinary corporate action (*e.g.*, charter or by-law amendments) by a corporation may require the favorable vote of more than a majority of the directors, or of the outstanding voting stock, of such corporation shall not alter the determination of voting power of stock in such corporation in accordance with the two preceding sentences.