



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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Date:

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Dear _____ :

This is in response to a letter from A's authorized representative, who has requested a ruling on the proper treatment of contributions of business holdings by a disqualified person which ultimately results in a combined ownership in excess of the permitted holdings under section 4943 of the Internal Revenue Code.

The information submitted shows that on February 7, 2003, A was recognized as exempt from federal income tax under section 501(a) of the Code, as an organization described in section 501(c)(3) and is a private foundation within the meaning of section 509(a). B and C are

both founding and current Directors of A. They serve as uncompensated foundation managers due to their status as Class One Directors. They will be substantial, if not sole, contributors to A.

B and C wish to contribute to percent of their interests in two partnerships to A. C owns a percent interest in D. B and C each own a % interest in E.

Both D and E derive more than % of their gross incomes from passive sources (e.g., interest income, dividend income, gain from sale of marketable equity securities and investment land, and rental income).

Section 4943(a)(1) of the Code imposes on excess holdings of any private foundation in a business enterprise during any taxable year which ends during the taxable period a tax equal to 5 percent of the value of such holdings.

Section 4943(c)(1) defines the term "excess business holdings" to mean, 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.

Section 4943(c)(3) states that 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".

Section 4943(d)(3) states that 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.

Section 4946(a)(1)(A) defines disqualified person as including a substantial contributor to the foundation.

Section 4946(a)(2) defines substantial contributor as a person described in section 507(d)(2).

Section 507(d)(2) defines substantial contributor in part as a person who contributed an aggregate amount of more than \$5,000 if it is more than 2 percent of the annual total contributions. Further, any person who is a substantial contributor on any date shall remain a substantial contributor for all subsequent periods.

Section 4946(a)(1)(B) defines foundation manager as a disqualified person.

Section 4946(b)(1) defines foundation manager as including an officer or director of the foundation.

Section 4946(a)(1)(C) defines a disqualified person as an owner of more than 20% 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 rated enterprise, which is a substantial contributor to the foundation.

Section 4946(a)(1)(D) defines a disqualified person as a member of the family of any individual described in subparagraph (A), (B), or (C).

Section 4946(a)(1)(E), (F) and (G) defines a disqualified person, as a corporation, a partnership, or trust, in which a persons described in subparagraph (A), (B), (C), or (D) holds more than 35 percent of the voting power, profit interests, or beneficial interest.

A has requested a ruling stating that the acceptance of the partnership interests from disqualified parties will not cause A to be subject to the excess business holdings excise tax imposed by section 4943 of the Code due to the passive nature of gross income received by each partnership.

B and C are disqualified persons with respect to A by serving as foundation managers, and due to their roles as substantial, if not sole, contributors to A.

B and C wish to initially fund A with the donation of partial interests in D and E. The contribution of these partnership interests will result in combined business holdings in excess of the 20 percent limit imposed by section 4943 of the Code. However, the gross income of both partnerships is derived from passive sources (e.g., interest income, dividend income, gain from the sale of marketable equity securities and investment land, and rental income). Thus, the partnership interests will be excluded from the calculation of excess business holding in light of the definition of a business enterprise as provided in section 4943 of the Code. The definition excludes a trade or business at least 95 percent of the gross income of which is derived from passive sources as being considered a business enterprise.

Accordingly, we rule that the acceptance by A of the partnership interests from disqualified parties will not cause A to be subject to the excess business holdings excise tax imposed by section 4943 of the Code due to the passive nature of gross income received by each partnership.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to Foundation's authorized representative. A copy of this letter should be kept in Foundation's permanent records.

If there are any questions about this ruling, please contact the person whose name and telephone are shown in the heading of this letter.

Sincerely,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3