

1st taxable year, it will be treated as a private foundation which is not an operating foundation as of the 1st day of such 2d, 3d, or 4th taxable year in which it fails to qualify as an operating foundation, except as otherwise provided by paragraph (d) of this section. Such status as a private foundation which is not an operating foundation will continue until such time as the organization is able to satisfy the tests set forth in §§ 53.4942(b)-1 and 53.4942(b)-2 by either the 3-out-of-4-year method or the aggregation method. For the status of grants or contributions made to such an organization with respect to sections 170 and 4942, see paragraph (d) of this section.

(c) *Transitional rule for existing organizations.* An organization organized before December 31, 1969 (including organizations deemed to be so organized by virtue of the principles of paragraph (e)(2) of § 53.4942(a)-2), but which is unable to satisfy the tests under §§ 53.4942(b)-1 and 53.4942(b)-2 for its first taxable year beginning after December 31, 1969 on the basis of its operations for taxable years prior to such taxable year by either the 3-out-of-4-year method or the aggregation method, will be treated as a new organization for purposes of paragraph (b) of this section only if:

(1) The organization changes its methods of operation prior to its first taxable year beginning after December 31, 1972 to conform to the requirements of §§ 53.4942(b)-1 and 53.4942 (b)-2;

(2) The organization has made a good faith determination (within the meaning of paragraph (b) (2) of the section) that it is likely to satisfy the tests set forth in §§ 53.4942(b)-1 and 53.4942(b)-2 prior to its first taxable year beginning after December 31, 1972 on the basis of its income or assets held, received, or distributed during its taxable years beginning in 1970 through 1972; and

(3) Such good faith determination is attached to the return the organization is required to file under section 6033 for its taxable year beginning in 1972.

(d) *Treatment of contributions—(1) In general.* The status of grants or contributions made to an operating foundation with respect to sections 170 and 4942 will not be affected until notice of change of status of such organization is

made to the public (such as by publication in the Internal Revenue Bulletin), unless the grant or contribution was made after:

(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