**Excess Business Holdings Compliance**

Under Section 4943 of the Internal Revenue Code (IRC), an excise tax is assessed on any private foundation’s excess business holdings in a business enterprise.

A business enterprise includes the active trade or conduct of a trade or business, including any activity regularly conducted to produce income from selling goods or performing services, that is an unrelated trade or business. This term does not include program related investments or functionally related businesses. It also does not include a trade or business at least 95% of the gross income of which is derived from passive sources.

 “Excess business holdings” is defined as the amount of stock or interest that the foundation would have to divest in order for the foundation’s remaining holdings to be permitted holdings. In most cases, the permitted holdings of a foundation are 20 percent of the voting stock, less the percentage of voting stock held by all disqualified persons of the foundation. If all disqualified persons together own 20 percent or less of the voting stock of an incorporated business enterprise, then the foundation’s nonvoting stock is also treated as permitted holdings. An exception to this rule exists in the case of an incorporated enterprise that is controlled by a third party, which allows the foundation and disqualified persons to collectively own up to thirty-five percent of the voting stock of the entity without those holdings being deemed excess business holdings. In the case of ownership in a partnership, the terms *voting stock* and *nonvoting stock* are replaced with *profit interest* and *capital interest*.

If a private foundation at any point in the year has excess business holdings in a business enterprise, a 10% excise tax is imposed as of the end of the taxable year. This excise tax is imposed on the largest amount of excess business holdings at any point during the taxable year, and it is imposed for any taxable year which ends during the taxable period. The taxable period begins on the date that the foundation first has excess holdings, and ends on the earlier of (1) the date of mailing a notice of deficiency with respect to the tax due related to the excess holdings, (2) the date on which the tax is assessed, or (3) the date the excess is eliminated. Furthermore, if the foundation still has excess holdings as of the close of the taxable period, a tax equal to 200 percent of the excess business holdings is assessed. A termination tax can be assessed in particularly egregious cases.

IRC §4943(c)(2)(C) provides for a 2 percent de minimis rule by which the foundation is not treated as having excess business holdings in any corporation in which it owns no more than 2 percent of the voting stock and no more than 2 percent of all outstanding shares of all classes of stock, irrespective of the holdings of disqualified persons in the same corporation. The 2% threshold is also of note because the foundation is required to disclose on its Form 990-PF whether it owned more than 2% of a business enterprise during the year.

There are additional exceptions to the tax on excess business holdings, including an exception when ownership in a business enterprise is donated or inherited rather than purchased by the foundation. In such a case, the foundation has a specified period of time to divest of such holdings. Additional information regarding these exceptions and other information regarding excess business holdings can be found at IRC §4943 as well as the instructions for Forms 4720 and 990-PF.

Because of the potential magnitude of excise taxes associated with failure to comply with the excess business holdings rules, the foundation reviews its holdings annually to ensure that its investments are below the 2 percent de minimis threshold. The process for this review is described in the following paragraphs.

In late December or January, letters are prepared by the Accountant to send to investment managers, asking for information on the Foundation’s holdings as of the end of the calendar year. Each letter briefly explains that the foundation is subject to certain rules under IRC §4943, and requests assistance in complying with these rules. The letters are reviewed and signed by the Vice President for Finance, then sent by the Accountant to the investment managers via e-mail in early January with a stated due date of February 1st.

Different information might be requested in each letter, depending on the type of investment that the Foundation has with that investment manager. Below are the types of investments and a description of the corresponding letter:

Separately Managed Accounts: The letter requests a listing of any business entities in the Foundation’s portfolio where the Foundation’s ownership of the entity is greater than 2%. The letter also requests that the corresponding percentage ownership for each of these entities be provided.

Mutual Funds/Commingled Funds: The letter requests the Foundation’s ownership percentage in the fund. The letter further requests that, if the Foundation’s ownership in the fund is greater than 2%, that the manager state whether the Foundation’s allocated ownership in any of the underlying investments is greater than 2%. If there are any entities in which the Foundation’s ownership is greater than 2%, then the manager is asked to provide the name of those entities as well as the Foundation’s ownership percentage in each of them.

Hedge Fund Portfolios: The letter requests the Foundation’s ownership percentage in each of the hedge funds in the portfolio. It further requests that, if the Foundation’s ownership in any fund exceeded 2%, the investment manager indicate whether the Foundation’s allocated ownership in any of the underlying investments is greater than 2%. If there are any entities in which the Foundation’s ownership is greater than 2%, then the manager is asked to provide the name of those entities as well as the Foundation’s ownership percentage in each of them.

Acacia: The letter requests the Foundation’s ownership percentage in the fund. As of 12/31/2012, the Foundation only had one investment through Acacia, so the letter requested that the manager provide the Foundation’s ownership in this investment. The manager was also asked to indicate whether the Foundation has other investments through Acacia. If other investments did exist that the Foundation was unaware of, the manager was asked to list the names of those entities as well as the Foundation’s ownership percentage in each of them.

Private Equity Portfolios: Because the Foundation’s ownership in individual private equities is very small and is known through regular reporting in Private i, letters are not sent on an annual basis to private equity managers.

Bond Portfolios: Letters are not sent to bond managers because bonds are debt instruments rather than ownership interests in a business enterprise.

Responses from investment managers are received by the Accountant or the Controller, then reviewed by the VP for Finance. If there is an issue, one of these individuals follows up with the manager to clarify and resolve the issue.

The Foundation has not had any issues to date. If there were, the investment manager would be asked to reduce the Foundation’s exposure in the investment.