

DESCRIPTION OF S. 1514;
A BILL RELATING TO PRIVATE FOUNDATION
LEASING OF BUSINESS ASSETS
LISTED FOR A HEARING

BY THE
SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT
OF THE
COMMITTEE ON FINANCE
ON JULY 25, 1977

PREPARED FOR THE USE OF THE
COMMITTEE ON FINANCE
BY THE STAFF OF THE
JOINT COMMITTEE ON TAXATION



JULY 22, 1977

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I. INTRODUCTION

The bill described in this pamphlet (S. 1514) has been scheduled by the Subcommittee on Taxation and Debt Management of the Committee on Finance for a hearing on July 25, 1977. The bill relates to leasing business assets by private foundation to a "disqualified person."

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the bill. The description indicates the present law treatment, the issue involved, an explanation of what the bill would do, the effective date of the bill, and the bill's revenue effect.

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II. DESCRIPTION

S. 1514—Mr. Allen (for himself, Mr. Sparkman, and Mr. Thurmond)

Private Foundation Leasing of Business Assets to Disqualified Persons

Present law

Under present law (sec. 4941 of the Internal Revenue Code), private foundations are generally prohibited from engaging in transactions with disqualified persons. The prohibited acts (referred to as acts of "self-dealing") include the "sale or exchange, or leasing, of property between a private foundation and a disqualified person". A "disqualified person" is defined to include anyone who is a "substantial contributor" to the foundation. A "substantial contributor" includes any person who has contributed more than \$5,000 to the foundation, if the total contributions from that person exceed 2 percent of the total contributions received by the foundation. Once a person is a substantial contributor, he remains so forever.

These provisions were added by the Tax Reform Act of 1969. In order to permit the orderly termination of arrangements existing in 1969 between private foundations and their disqualified persons, the 1969 Act (sec. 101(1)(2)(C)) permitted then-existing leasing arrangements to continue for up to 10 years (through 1979), but only so long as the foundation was not disadvantaged by the terms of the lease. In addition, the Tax Reform Act of 1976 amended the 1969 Act to allow these permitted transitional leases to be terminated by a sale of the leased property by the foundation to disqualified persons. This provision (see 101(1)(2)(F) of the 1969 Act) required that any such sale must be completed before January 1, 1978.

Another provision of present law (sec. 4943) limits the percentage of ownership which a foundation (and all its disqualified persons) can hold in any single business. In general, the combined business ownership of a foundation and disqualified persons in any business may not exceed 20 percent (35 percent ownership by the foundation and disqualified persons together is permitted where an unrelated group is shown to be in control of the business). These provisions were also added by the Tax Reform Act of 1969, and include transitional rules to allow foundations an adequate opportunity to dispose of their then-existing holdings. Under these transitional rules, where a foundation itself owned more than 95 percent of the voting stock in a business in 1969, an initial transitional period of 20 years (generally through May 26, 1989) was provided for the foundation to reduce its combined ownership (together with disqualified persons) to 50 percent. Where lesser percentages were owned in 1969, transitional periods

of 10 and 15 years were provided. The Act also allowed foundations to dispose of their excess holdings by sales to disqualified persons (sec. 101 (1) (2) (B) of the 1969 Act.)

In summary, the Congress—

(1) provided restrictions on foundation involvement in ownership of businesses and forbade completely continuing leasing relationships with disqualified persons,

(2) provided transitional periods for disposing of existing businesses and terminating continuing relationships with disqualified persons, and

(3) permitted self-dealing sales only if they would facilitate the disposition of excess business holdings or the termination of continuing lease relationships.

Issues

The bill presents several related issues:

First, whether there should be a permanent "grandfather clause" for certain cases permitting indefinite continuation of a lease of property between a private foundation and disqualified persons.

Second, whether the present law's 10-year period for terminating leases in existence in 1969 should be extended an additional 10 years (through 1989).

Third, whether a private foundation should be permitted to sell such leased property to a disqualified person at any time through the end of 1989.

Explanation of the bill

The bill would permit, in certain circumstances, the indefinite continuation of a lease between a private foundation and a disqualified person if the lease was in existence on October 9, 1969. Subsequent renewals of such a lease would not disqualify the lease for purposes of this bill. This would be permitted only if the following conditions are met: (1) the lessor is a corporation whose stock is wholly owned by the private foundation; (2) the lease did not violate the limited restrictions on self-dealing in effect prior to the Tax Reform Act of 1969; (3) the terms of the lease are at least as favorable to the private foundation's wholly owned subsidiary as a lease entered into in an arm's length transaction would be; (4) the private foundation's subsidiary corporation is not itself exempt from income tax; and (5) the disqualified person (the lessee) became a disqualified person solely because of contributions made to the private foundation before October 9, 1969.

The bill would extend through December 31, 1989, a transitional rule permitting the sale of stock by a private foundation to disqualified persons even though the private foundation was not obligated to dispose of that stock.

The bill would extend through December 31, 1989, the present transitional rule permitting the continuation of leases with disqualified persons if those leases were in effect on October 9, 1969.

The bill would extend through December 31, 1989, the existing transitional rule permitting the sale of leased property that was subject to the transitional rule described in the preceding paragraph.

The intended beneficiaries¹ of the bill are: Public Welfare Foundation, Inc., a private foundation organized by Charles E. Marsh; the taxable, wholly-owned subsidiaries of Public Welfare Foundation, Inc. (The Spartanburg Herald and Journal, Inc., The Gadsden Times, Inc., and The Tuscaloosa News, Inc.); and three newspaper operators (Newspaper Management-Production, Inc., Gadsden Times Publishing Corporation, and Tuscaloosa Newspapers, Inc.) who lease the assets owned by Public Welfare Foundation, Inc.'s wholly-owned subsidiaries.

The principal owners of the three operating companies are, respectively, Phil Buchheit, Frank Halderman, Sr., and James B. Boone, Jr. The newspapers operate in South Carolina and Alabama.

Alternatives

The staff understands that there are several alternative proposals which may be presented in connection with the consideration of this bill. In general, these proposals would limit the scope of the relief provided by the bill. Under one proposal, the bill would limit the extension of the transitional leases only to 1989 and only in the circumstances described above in the discussion of the provision of S. 1514 relating to the indefinite continuation of certain leases. Under a second proposal, the definition of a "substantial contributor" would be changed so that contributions made in lieu of rental payments on certain leases made prior to 1969 would not be taken into account in deciding whether any person met the 2-percent and the \$5,000 tests under section 507 for purposes of determining whether that person was a "substantial contributor."

Effective date

The bill would take effect upon enactment.

Revenue effect

The bill is not expected to have any effect on the revenues.

¹The first provision in the bill, permitting an indefinite continuation of certain leases, appears to be drafted so as to apply only to the situation presented by the intended beneficiaries listed above. The second provision does not appear to relate to that situation. The remaining two provisions apply across-the-board, and so would affect all private foundations with "grandfather clause" leases.