

Charitable Bequest of a Business and the Problems That Follow

by James F. McDonough, Jr. on September 23, 2013

It is not difficult to leave a business to charity, one makes a bequest. The difficulty, however, arises from the administrative and compliance issues faced as a result of such a charitable bequest make it impractical in most instances. The Internal Revenue Code (IRC) imposes numerous restrictions on these tax practices and discourages non-profit organizations from competing directly against for-profit companies in commercial setting. (Imagine the competitive advantage you would have if your business were not subject to income tax.)

IRC §4943 prohibits private foundations from having excess business holdings in a business enterprise. A private foundation is a type of exempt organization that receives substantial support from only a few contributors or sources. Unlike many of the well-known public charities that receive contributions from thousands of people, a private foundation is controlled by a few substantial contributors. The IRC imposes tighter restrictions upon private foundations because of the absence of public oversight and de facto control by the contributors is suspect in the eyes of the IRS.

There are two exceptions. First, a business whose income is substantially (95% or more) passive in character. This makes sense because the IRC has the opportunity to tax a corporation that pays dividends, so there is no fear that business income will escape taxation.

The second exception is for a functionally related business (“FRB”) and it is rarely used. This is why PLR 201323029 is so interesting. FRB is defined as a business that is not an unrelated trade or business or is an activity which is carried on within a group of activities which are related to the exempt purpose of an organization. A classic example is a medical journal that reports on medical developments, but also contains medical advertising which is deemed related to the exempt purpose.

PLR 201323029 described an artist’s foundation that was dedicated to the creation and exhibition of art as well as art education. The artist’s business was held in a for-profit corporation. Upon the artist’s death, ownership of the corporation’s shares would pass to the foundation that would use the revenue to support its programs.

The usefulness of this PLR may be limited; however, it is important to notice that the foundations efforts to advance art were ongoing during the artist’s lifetime. It may have been helpful to obtaining the ruling that the charitable activities being conducted were already qualified and the applicant need only promise that they continue after death.