

## Newman's Own and a New Excess Business Holdings Rule for Private Foundations

What happens when a private nonprofit foundation is gifted a for-profit corporation? This is a dilemma Newman's Own Foundation has been facing after it was bequeathed the for-profit food company founded by the late actor Paul Newman. Because it was the sole owner of the business, Newman's Own Foundation faced a severe tax penalty if it did not reduce its ownership interest.<sup>1</sup> In its thirty-fifth year of giving, Newman's Own Foundation, a 501(c)(3) charitable organization, boasts a total donation of \$500 million to charities since its creation in 1982.<sup>2</sup> Thus, the foundation had a track record of providing significant public benefit, and it had friends who wanted to help it continue to provide public benefit.

The IRS has regulations governing excess business holdings in private foundations. These excess business holdings are defined as "the amount of stock or other interests in a business enterprise that exceeds the permitted holdings."<sup>3</sup> The IRS permits a private foundation to hold up to twenty percent of a business, and the private foundation typically has up to ninety days after knowing of its excess holdings to dispose of them.<sup>4</sup> An exception is provided when the excess business holdings are acquired through a gift. The exception grants the private foundation a five-year period to dispose of the holdings or reduce them to the permitted percentage.<sup>5</sup> These tax laws were created in 1969 as a means to prevent private foundations "from owning more than a small stake in private businesses."<sup>6</sup> The provisions were intended to prevent wealthy individuals from utilizing private foundations as "tax shelters," and the potential penalties are stiff to discourage abuse. If a foundation violates these provisions, it is subject to a 200 percent tax.<sup>7</sup>

Though the transfer of ownership of the food company occurred in 2008, for the last ten years Newman's Own Foundation has been working with legislators to change the tax laws that would require the sale or closure of the for-profit food company. The IRS gave Newman's Own Foundation until November 2018 (an extra five years) to divest its interests in the for-profit corporation to prevent the steep tax penalty.<sup>8</sup> Newman's Own's leadership wanted to keep the company, and has spent the last ten years working with legislators to find an exemption to this tax rule because the severe 200 percent tax penalty would cause the foundation to fail.<sup>9</sup>

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<sup>1</sup> Rob Meiksins, *Newman's Own Foundation and the Tax Overhaul: Two Cases of "Who Knew,"* NONPROFIT QUARTERLY (Dec. 12, 2017), <https://nonprofitquarterly.org/2017/12/12/newmans-foundation-tax-overhaul-two-cases-knew>.

<sup>2</sup> *Newman's Own Foundation Reaches Milestone of \$500 Million to Charity*, YAHOO! FINANCE (Feb. 1, 2018), <https://finance.yahoo.com/news/newmans-own-foundation-reaches-milestone-111000162.html>.

<sup>3</sup> Internal Revenue Service, *Excess Business Holdings of Private Foundations Defined*, IRS (Sept. 29, 2017), <https://www.irs.gov/charities-non-profits/private-foundations/excess-business-holdings-of-private-foundation-defined>.

<sup>4</sup> *Id.*

<sup>5</sup> Internal Revenue Service, *Gifts or Bequests of Business Holdings*, IRS (April 2, 2018), <https://www.irs.gov/charities-non-profits/private-foundations/gifts-or-bequests-of-business-holdings>.

<sup>6</sup> Brian Faler, *Newman's Own Faces Mammoth Tax Bill After Lawmakers Fail to Spare the Foundation*, POLITICO (Dec. 7, 2017), <https://www.politico.com/story/2017/12/07/newmans-own-tax-bill-congress-212925>.

<sup>7</sup> Meiksins, *supra* note 1.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

After extensive lobbying by Newman’s Own Foundation, an exemption to the tax penalty was initially included in the 2017 tax overhaul bill; however, this exemption was in violation of the Byrde Rule, which prevents extraneous inclusions in the process of budget reconciliation.<sup>10</sup> On February 9, 2018, President Donald Trump signed into a law a bill that would protect Newman’s Own from facing the 200 percent tax penalty. The Philanthropic Enterprise Act of 2017, part of the Bipartisan Budget Act of 2018, includes what is known colloquially as the “Newman’s Own Exemption.”<sup>11</sup> The Philanthropic Enterprise Act is an amendment to the tax revenue code that allows “private foundations to take complete ownership of a for-profit corporation under certain circumstances.”<sup>12</sup> These circumstances include: (1) 100 percent ownership of the business’s voting stock by the private foundation; (2) independent management of the business; and (3) distribution of all profits from the business to the foundation.<sup>13</sup>

The long-term implications of this law are yet to be seen. Its short-term implications ensure that Newman’s Own Foundation can continue functioning as the 100 percent owner of the for-profit food business. It seems the bill was passed with the intention of ensuring the continuance of this ownership arrangement and the continuance of the Newman’s Own Foundation, but the far reaching implications of its applicability to all other private foundations have yet to be seen.<sup>14</sup> The creation of limitations, such as independent management and a requirement that all profits return to the foundation, appear to be safeguards written into the law to prevent private foundations from running afoul of the original concern with preventing tax shelter.

However, this bill does not apply solely to Newman’s Own Foundation. Total separation of the two entities is not required under the Act; the opportunity still exists for the private foundation board to appoint the board of the business.<sup>15</sup> In addition to appointing the board members of the for-profit corporation, the board of the private foundation may exercise additional rights, depending on the jurisdiction of incorporation.<sup>16</sup> In some jurisdictions, for example, “a sole shareholder has the right to inspect the books and records of the company and to sue the directors for breach of fiduciary duty (including the duty to pursue a social mission, if the company is a benefit corporation.)”<sup>17</sup> These other powers may include mergers, acquisitions, dissolutions, decision vetoes, and sales of assets.<sup>18</sup> It is likely, in the coming years, that nonprofit law will have the opportunity to further explore the far-reaching effects this bill may have on for-profit businesses held by private foundations.

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<sup>10</sup> Rob Meiksins, *The Newman’s Own Philanthropic Exception is Now Law — What Will the Consequences Be?*, NONPROFIT QUARTERLY (March 30, 2018), <https://nonprofitquarterly.org/2018/03/30/newmans-philanthropic-exception-now-law-will-consequences/>.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Philanthropic Enterprise Act of 2017, H.R. 3035, 115th Cong. (2018).

<sup>14</sup> Andrew Katzenberg, *Newman’s Own Exception Quietly Passed*, WEALTH MGMT. (March 27, 2018), <http://www.wealthmanagement.com/philanthropy/newman-s-own-exception-quietly-passed>.

<sup>15</sup> Meiksins, *supra* note 10.

<sup>16</sup> Allen Bromberger, *Newman’s Own Gets a New Life*, PHILANTHROPIC NEWS DIGEST (March 2, 2018), <http://pndblog.typepad.com/pndblog/2018/03/newmans-owns-gets-a-new-life.html>.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

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