***Ruth E. & Ralph Friedman Foundation, Inc. v. Commissioner, 71 T. C. 40 (1978)***

Capital gains from the sale of donated stock by a private foundation are subject to the 4% excise tax on investment income, even if the stock is sold immediately after donation.

**Summary**

The Ruth E. & Ralph Friedman Foundation, a tax-exempt private foundation, received a donation of Kerr McGee Corp. stock in November 1973 and sold it in December of the same year. The IRS assessed a 4% excise tax on the capital gains from this sale under Section 4940(a) of the Internal Revenue Code. The Tax Court upheld the validity of the Treasury Regulation that subjected these gains to tax, reasoning that the stock was property of a type generally held for investment purposes. Additionally, the court determined that the foundation's basis in the stock for calculating gain was the donors' basis, not the stock's fair market value at the time of donation.

**Facts**

On November 14, 1973, Ralph and Ruth Friedman donated 334 shares of Kerr McGee Corp. stock to the Ruth E. & Ralph Friedman Foundation, Inc. , a tax-exempt private foundation. The stock was sold by the foundation in two transactions on December 4 and December 11, 1973. The Friedmans claimed a charitable contribution deduction for the donation on their 1973 joint income tax return. The foundation used the proceeds from the sale to make charitable contributions. The IRS assessed a 4% excise tax on the capital gains from the sale of the stock under Section 4940(a).

**Procedural History**

The IRS determined a deficiency in the foundation's excise tax for 1973, which the foundation contested. The case was heard by the United States Tax Court, which upheld the IRS's position and ruled in favor of the Commissioner.

**Issue(s)**

1. Whether the capital gains from the sale of donated stock by a private foundation are subject to the 4% excise tax on investment income under Section 4940(a).
2. If the gains are taxable, what is the foundation's basis in the donated stock for calculating the amount of the gain?

**Holding**

1. Yes, because the stock was property of a type generally held for investment purposes, and the Treasury Regulation extending the tax to such property was valid.

© 2025 SCOTUSreports.com. All rights reserved. 

2. No, because the foundation's basis in the stock was the donors' basis, not the fair market value at the time of donation, as determined under Sections 1011 and 1015 and the applicable Treasury Regulation.

**Court's Reasoning**

The court upheld the Treasury Regulation's inclusion of capital gains from donated stock sold immediately upon receipt in the definition of taxable investment income. The court reasoned that the regulation was a permissible interpretation of Section 4940(c)(4)(A), which taxes gains from property used for the production of income, as the stock was property of a type that typically produces income through appreciation. The court rejected the foundation's argument that the regulation was an illegal exercise of legislative power, noting that Congress had granted the Treasury Department authority to promulgate such regulations and to limit their retroactivity. For the basis issue, the court followed the statutory rules under Sections 1011 and 1015, which dictate that the basis for determining gain in the hands of a donee is the carryover basis of the donor, and found the applicable Treasury Regulation consistent with these provisions.

**Practical Implications**

This decision clarifies that private foundations must consider the tax implications of selling donated assets immediately upon receipt. Foundations should be aware that capital gains from such sales are subject to the 4% excise tax on investment income, even if the asset was not held long enough to generate dividends or interest. The ruling also reinforces the use of the donor's basis for calculating gains, which may affect the timing and strategy of asset sales by foundations. This case has been influential in subsequent interpretations of the tax treatment of private foundation investment income, and it underscores the importance of understanding the Treasury Regulations in this area of tax law.

© 2025 SCOTUSreports.com. All rights reserved. 