

Rev. Rul. 74-403, 1974-2 C.B. 381

Private foundation; computation of gain on sale of listed securities. For purposes of computing a private foundation's tax on net investment income under section 4940(a) of the Code, the net capital gain on the sale of a listed common stock purchased before December 31, 1969 is the difference between the selling price and the greater of (1) the foundation's basis in the stock, or (2) the mean average of the highest and lowest quotations on December 31, 1969 plus or minus subsequent adjustment to the date of sale.

The Internal Revenue Service has been asked what is the net capital gain for purposes of the Federal excise tax imposed by section 4940 of the Internal Revenue Code of 1954 on net investment income of a private foundation under the circumstances described below.

A private foundation bought 100 shares of common stock of the M Corporation on February 27, 1967, at a purchase price of 4,000 dollars. The foundation sold the stock on December 27, 1973, for 10,000 dollars. At all times the stock was registered and listed on a recognized securities exchange. On December 31, 1969, the sales of M Corporation common stock on the exchange ranged from a high of 45 dollars per share to a low of 40 dollars per share. The closing price for such stock on that date was 44 dollars per share. No adjustments to basis were required for the period the stock was held by the foundation.

Section 4940(c)(4) of the Code provides, in part, that in determining net capital gain there is taken into account the gains and losses from the sale or other disposition of property used for the production of interest, dividends, rents, and royalties, and property used for the production of income which is included in computing the tax under section 511 (except to the extent such gains or losses are taken into account in computing such tax).

Section 53.4940-1(f)(2)(i) of the Foundation Excise Tax Regulations provides in cases where property is held by a private foundation on December 31, 1969, and continuously thereafter until date of disposition that the basis for determining gain on sale or other disposition of the property shall be the greater of fair market value on December 31, 1969, (plus or minus all adjustments after such date and before sale or other disposition) and basis as determined under the rules of part II, subchapter O, chapter 1, subtitle A of the Internal Revenue Code.

Section 53.4940-1(c) of the regulations states that net investment income shall be determined under the principles of subtitle A, except to the extent they may be inconsistent with section 4940 of the Code.

Where fair market value is an element in the computation of gain for purposes of subtitle A, the principles for valuation of stocks and bonds set forth in section 20.2031-2 of the Estate Tax Regulations (relating to subtitle B) are deemed generally applicable and are followed to the extent they do not conflict with the Code or regulations under subtitle A. See Rev. Rul. 68-609, 1968-2 C.B. 327. Section 20.2031-2(b) of the regulations provides that if there is a market for stocks or bonds traded on a stock exchange, in an over-the-counter market, or otherwise, the fair market value of such stocks or bonds shall consist of the mean between the highest and lowest quoted selling prices on the valuation date.

In the case in question the foundation's gain is the difference between the amount received upon sale of M Corporation's common stock and the fair market value as of December 31, 1969, since the fair market value on that date was higher than the foundation's basis in such stock. Consistent with determinations under subtitle A of the fair market value of stocks and bonds for which there is a market, the determination of the fair market value of a stock or bond as of December 31, 1969, for purposes of computing gain on sale or other disposition under section 4940(c)(4) of the Code is made by taking the mean average of the high and low market quotations of the stock or bond on that date.

Accordingly, in computing the net capital gain for section 4940(c)(4) purposes the fair market value on December 31, 1969, of the investment security sold is determined by reference to the mean of the high and low market quotations of the security on that date. Thus, the foundation's net capital gain in the above matter is computed as follows:

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| Amount received from sale of 100 shares of M Corporation common stock on 12/27/73 | \$10,000 |
| Less-fair market value of M Corporation common as of 12/31/69 $(\$45 + \$40) / 2 \times 100 \text{ shares}$ | 4,250 |
| Net capital gain under section 4940(c)(4) | \$ 5,750 |