

Part III - Administrative, Procedural, and Miscellaneous

Distributions to Private Foundations from Trusts or Estates; Net Investment Income

Notice 2004-35

PURPOSE

This notice announces that the Internal Revenue Service intends to propose regulations modifying the regulations under section 4940 of the Internal Revenue Code of 1986, as amended, with respect to distributions received by private foundations from trusts and estates.

BACKGROUND

Section 4940 imposes a tax on private foundations based on the foundation's net investment income. Net investment income is defined in section 4940(c)(1) as the amount by which the sum of the gross investment income and the capital gain net income exceeds certain deductions. Net investment income is to be determined under the principles of subtitle A except to the extent inconsistent with the principles of section 4940.

Treas. Reg. § 53.4940-1(d)(2) states that a distribution from a trust described in section 4947(a)(1) or (2) or from an estate does not retain its character in the hands of the distributee private foundation. Thus, these distributions are not included in net investment income for purposes of section 4940. Treas. Reg. § 53.4940-1(d)(2) also states that a distribution from a section 4947(a)(2) trust that is attributable to transfers in trust after May 26, 1969, retains its character in the hands of the distributee private foundation unless the income is taken into account as a result of the application of section 671. The regulation is silent on the treatment of distributions from trusts other than trusts described in section 4947.

Because distributions of income received by a private foundation from some types of trusts, but not other types of trusts or estates, are included in the private foundation's net investment income for purposes of section 4940, Treas. Reg. § 53.4940-1(d)(2) leads to inconsistent results. For example, a distribution of income made during the administration of an estate for which a deduction is claimed under section 642(c) does not retain its character in the hands of the distributee private foundation. However, a distribution of income from a non-grantor charitable lead trust described in section 4947(a)(2) for which the trust claims a section 642(c) deduction does retain its character in the hands of the distributee private foundation, if the income is attributable to amounts placed in trust after May 26, 1969.

After studying the application of section 4940 and Treas. Reg. § 53.4940-1(d)(2) to distributions from various types of trusts and estates, the Treasury Department and the Internal Revenue Service have concluded that the disparate treatment of distributions under section 4940 is no longer appropriate.

PROPOSED ACTION

The Treasury Department and the Internal Revenue Service intend to propose regulations modifying Treas. Reg. §53.4940-1(d)(2) to provide that a private foundation's net investment income for purposes of section 4940 does not include distributions from trusts and estates. Until further guidance is promulgated, income distributions from trusts and estates will not retain their character in the hands of a distributee private foundation for purposes of determining the foundation's net investment income under section 4940(c).

CURRENT RETURN PROCESSING

For current tax returns, any private foundation to which this notice applies should mark, "Filed pursuant to Notice 2004-35" on the front page of its Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation. Returns should be completed in accordance with this notice pending corresponding changes to Form 990-PF and the accompanying instructions.

REFUND PROCESSING

For years in which the statute of limitations has not expired and for which a refund of section 4940 taxes paid is sought, the private foundation must file an amended Form 990-PF. The private foundation should mark the front page of the amended return (or returns) "Filed pursuant to Notice 2004-35."

COMMENTS

The Service welcomes comments and suggestions relating to the amendment of the regulations on distributions from trusts and estates to private foundations. Written comments should be submitted by August 9, 2004, to CC:PA:LPD:RU (Notice 2004-35), Room 5203, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m., Monday through Friday to CC:PA:LPD:RU (Notice 2004-35), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave. NW, Washington D.C. Alternatively, comments may be submitted electronically via e-mail to the following address: Notice.Comments@irs.counsel.treas.gov. All comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this notice is Ronald B. Weinstock of the Office of Division Counsel/ Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice contact Mr. Weinstock at (202) 622-3094 or contact Oksana O. Xenos of the Office of the Commissioner (Tax Exempt and Government Entities) at 202-283-9469 (not a toll-free number).