

§ 1.652(b)-2 Allocation of income items.

(a) The amounts specified in § 1.652(a)-1 which are required to be included in the gross income of a beneficiary are treated as consisting of the same proportion of each class of items entering into distributable net income of the trust (as defined in section 643(a)) as the total of each class bears to such distributable net income, unless the terms of the trust specifically allocate different classes of income to different beneficiaries, or unless local law requires such an allocation. For example: Assume that under the terms of the governing instrument, beneficiary A is to receive currently one-half of the trust income and beneficiaries B and C are each to receive currently one-quarter, and the distributable net income of the trust (after allocation of expenses) consists of dividends of \$10,000, taxable interest of \$10,000, and tax-exempt interest of \$4,000. A will be deemed to have received \$5,000 of dividends, \$5,000 of taxable interest, and \$2,000 of tax-exempt interest; B and C will each be deemed to have received \$2,500 of dividends, \$2,500 of taxable interest, and \$1,000 of tax-exempt interest. However, if the terms of the trust specifically allocate different classes of income to different beneficiaries, entirely or in part, or if local law requires such an allocation, each beneficiary will be deemed to have received those items of income specifically allocated to him.

(b) The terms of the trust are considered specifically to allocate different classes of income to different beneficiaries only to the extent that the allocation is required in the trust instrument, and only to the extent that it has an economic effect independent of the income tax consequences of the allocation. For example:

(1) Allocation pursuant to a provision in a trust instrument granting the trustee discretion to allocate different classes of income to different beneficiaries is not a specific allocation by the terms of the trust.

(2) Allocation pursuant to a provision directing the trustee to pay all of one income to A, or \$10,000 out of the income to A, and the balance of the income to B, but directing the trustee first to allocate a specific class of income to A's share (to the extent there

is income of that class and to the extent it does not exceed A's share) is not a specific allocation by the terms of the trust.

(3) Allocation pursuant to a provision directing the trustee to pay half the class of income (whatever it may be) to A, and the balance of the income to B, is a specific allocation by the terms of the trust.

§ 1.652(b)-3 Allocation of deductions.

Items of deduction of a trust that enter into the computation of distributable net income are to be allocated among the items of income in accordance with the following principles:

(a) All deductible items directly attributable to one class of income (except dividends excluded under section 116) are allocated thereto. For example, repairs to, taxes on, and other expenses directly attributable to the maintenance of rental property or the collection of rental income are allocated to rental income. See § 1.642(e)-1 for treatment of depreciation of rental property. Similarly, all expenditures directly attributable to a business carried on by a trust are allocated to the income from such business. If the deductions directly attributable to a particular class of income exceed that income, the excess is applied against other classes of income in the manner provided in paragraph (d) of this section.

(b) The deductions which are not directly attributable to a specific class of income may be allocated to any item of income (including capital gains) included in computing distributable net income, but a portion must be allocated to nontaxable income (except dividends excluded under section 116) pursuant to section 265 and the regulations thereunder. For example, if the income of a trust is \$30,000 (after direct expenses), consisting equally of \$10,000 of dividends, tax-exempt interest, and rents, and income commissions amount to \$3,000, one-third (\$1,000) of such commissions should be allocated to tax-exempt interest, but the balance of \$2,000 may be allocated to the rents or dividends in such proportions as the trustee may elect. The fact that the governing instrument or applicable local law treats certain items of deduction

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as attributable to corpus or to income not included in distributable net income does not affect allocation under this paragraph. For instance, if in the example set forth in this paragraph the trust also had capital gains which are allocable to corpus under the terms of the trust instrument, no part of the deductions would be allocable thereto since the capital gains are excluded from the computation of distributable net income under section 643(a)(3).

(c) Examples of expenses which are considered as not directly attributable to a specific class of income are trustee's commissions, the rental of safe deposit boxes, and State income and personal property taxes.

(d) To the extent that any items of deduction which are directly attributable to a class of income exceed that class of income, they may be allocated to any other class of income (including capital gains) included in distributable net income in the manner provided in paragraph (b) of this section, except that any excess deductions attributable to tax-exempt income (other than dividends excluded under section 116) may not be offset against any other class of income. See section 265 and the regulations thereunder. Thus, if the trust has rents, taxable interest, dividends, and tax-exempt interest, and the deductions directly attributable to the rents exceed the rental income, the excess may be allocated to the taxable interest or dividends in such proportions as the fiduciary may elect. However, if the excess deductions are attributable to the tax-exempt interest, they may not be allocated to either the rents, taxable interest, or dividends.

§ 1.652(c)-1 Different taxable years.

If a beneficiary has a different taxable year (as defined in section 441 or 442) from the taxable year of the trust, the amount he is required to include in gross income in accordance with section 652 (a) and (b) is based on the income of the trust for any taxable year or years ending with or within his taxable year. This rule applies to taxable years of normal duration as well as to so-called short taxable years. Income of the trust for its taxable year or years is determined in accordance with

its method of accounting and without regard to that of the beneficiary.

§ 1.652(c)-2 Death of individual beneficiaries.

If income is required to be distributed currently to a beneficiary, by a trust for a taxable year which does not end with or within the last taxable year of a beneficiary (because of the beneficiary's death), the extent to which the income is included in the gross income of the beneficiary for his last taxable year or in the gross income of his estate is determined by the computations under section 652 for the taxable year of the trust in which his last taxable year ends. Thus, the distributable net income of the taxable year of the trust determines the extent to which the income required to be distributed currently to the beneficiary is included in his gross income for his last taxable year or in the gross income of his estate. (Section 652(c) does not apply to such amounts.) The gross income for the last taxable year of a beneficiary on the cash basis includes only income actually distributed to the beneficiary before his death. Income required to be distributed, but in fact distributed to his estate, is included in the gross income of the estate as income in respect of a decedent under section 691. See paragraph (e) of § 1.663(c)-3 with respect to separate share treatment for the periods before and after the decedent's death. If the trust does not qualify as a simple trust for the taxable year of the trust in which the last taxable year of the beneficiary ends, see section 662(c) and § 1.662(c)-2.

§ 1.652(c)-3 Termination of existence of other beneficiaries.

If the existence of a beneficiary which is not an individual terminates, the amount to be included under section 652(a) in its gross income for its last taxable year is computed with reference to §§ 1.652(c)-1 and 1.652(c)-2 as if the beneficiary were a deceased individual, except that income required to be distributed prior to the termination but actually distributed to the beneficiary's successor in interest is included in the beneficiary's income for its last taxable year.