

§ 1.663(b)-2

years of a trust beginning before January 1, 1969, the fiduciary of the trust may elect under section 663(b) to treat distributions within the first 65 days following such taxable year as amounts which were paid or credited on the last day of such taxable year, if:

(1) The trust was in existence prior to January 1, 1954;

(2) An amount in excess of the income of the immediately preceding taxable year may not (under the terms of the governing instrument) be distributed in any taxable year; and

(3) The fiduciary elects (as provided in § 1.663(b)-2) to have section 663(b) apply.

[T.D. 7204, 37 FR 17135, Aug. 25, 1972]

§ 1.663(b)-2 Election.

(a) *Manner and time of election; irrevocability*—(1) *When return is required to be filed.* If a trust return is required to be filed for the taxable year of the trust for which the election is made, the election shall be made in the appropriate place on such return. The election under this subparagraph shall be made not later than the time prescribed by law for filing such return (including extensions thereof). Such election shall become irrevocable after the last day prescribed for making it.

(2) *When no return is required to be filed.* If no return is required to be filed for the taxable year of the trust for which the election is made, the election shall be made in a statement filed with the internal revenue office with which a return by such trust would be filed if such trust were required to file a return for such taxable year. See section 6091 and the regulations thereunder for place for filing returns. The election under this subparagraph shall be made not later than the time prescribed by law for filing a return if such trust were required to file a return for such taxable year. Such election shall become irrevocable after the last day prescribed for making it.

(b) *Elections under prior law.* Elections made pursuant to section 663(b) prior to its amendment by section 331(b) of the Tax Reform Act of 1969 (83 Stat. 598), which, under prior law, were irrevocable for the taxable year for which the election was made and all subsequent years, are not effective for tax-

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able years beginning after December 31, 1968. In the case of a trust for which an election was made under prior law, the fiduciary shall make the election for each taxable year beginning after December 31, 1968, for which the treatment provided by section 663(b) is desired.

[T.D. 7204, 37 FR 17135, Aug. 25, 1972]

§ 1.663(c)-1 Separate shares treated as separate trusts or as separate estates; in general.

(a) If a single trust (or estate) has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts (or estates) for the sole purpose of determining the amount of distributable net income allocable to the respective beneficiaries under sections 661 and 662. Application of this rule will be significant in, for example, situations in which income is accumulated for beneficiary A but a distribution is made to beneficiary B of both income and corpus in an amount exceeding the share of income that would be distributable to B had there been separate trusts (or estates). In the absence of a separate share rule B would be taxed on income which is accumulated for A. The division of distributable net income into separate shares will limit the tax liability of B. Section 663(c) does not affect the principles of applicable law in situations in which a single trust (or estate) instrument creates not one but several separate trusts (or estates), as opposed to separate shares in the same trust (or estate) within the meaning of this section.

(b) The separate share rule does not permit the treatment of separate shares as separate trusts (or estates) for any purpose other than the application of distributable net income. It does not, for instance, permit the treatment of separate shares as separate trusts (or estates) for purposes of:

(1) The filing of returns and payment of tax,

(2) The deduction of personal exemption under section 642(b), and

(3) The allowance to beneficiaries succeeding to the trust (or estate) property of excess deductions and unused net operating loss and capital loss

carryovers on termination of the trust (or estate) under section 642(h).

(c) The separate share rule may be applicable even though separate and independent accounts are not maintained and are not required to be maintained for each share on the books of account of the trust (or estate), and even though no physical segregation of assets is made or required.

(d) Separate share treatment is not elective. Thus, if a trust (or estate) is properly treated as having separate and independent shares, such treatment must prevail in all taxable years of the trust (or estate) unless an event occurs as a result of which the terms of the trust (or estate) instrument and the requirements of proper administration require different treatment.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, as amended by T.D. 8849, 64 FR 72543, Dec. 28, 1999]

§ 1.663(c)-2 Rules of administration.

(a) *When separate shares come into existence.* A separate share comes into existence upon the earliest moment that a fiduciary may reasonably determine, based upon the known facts, that a separate economic interest exists.

(b) *Computation of distributable net income for each separate share—(1) General rule.* The amount of distributable net income for any share under section 663(c) is computed as if each share constituted a separate trust or estate. Accordingly, each separate share shall calculate its distributable net income based upon its portion of gross income that is includible in distributable net income and its portion of any applicable deductions or losses.

(2) *Section 643(b) income.* This paragraph (b)(2) governs the allocation of the portion of gross income includible in distributable net income that is income within the meaning of section 643(b). Such gross income is allocated among the separate shares in accordance with the amount of income that each share is entitled to under the terms of the governing instrument or applicable local law.

(3) *Income in respect of a decedent.* This paragraph (b)(3) governs the allocation of the portion of gross income includible in distributable net income that is income in respect of a decedent

within the meaning of section 691(a) and is not income within the meaning of section 643(b). Such gross income is allocated among the separate shares that could potentially be funded with these amounts irrespective of whether the share is entitled to receive any income under the terms of the governing instrument or applicable local law. The amount of such gross income allocated to each share is based on the relative value of each share that could potentially be funded with such amounts.

(4) *Gross income not attributable to cash.* This paragraph (b)(4) governs the allocation of the portion of gross income includible in distributable net income that is not attributable to cash received by the estate or trust (for example, original issue discount, a distributive share of partnership tax items, and the pro rata share of an S corporation's tax items). Such gross income is allocated among the separate shares in the same proportion as section 643(b) income from the same source would be allocated under the terms of the governing instrument or applicable local law.

(5) *Deductions and losses.* Any deduction or any loss which is applicable solely to one separate share of the trust or estate is not available to any other share of the same trust or estate.

(c) *Computations and valuations.* For purposes of calculating distributable net income for each separate share, the fiduciary must use a reasonable and equitable method to make the allocations, calculations, and valuations required by paragraph (b) of this section.

[T.D. 8849, 64 FR 72543, Dec. 28, 1999]

§ 1.663(c)-3 Applicability of separate share rule to certain trusts.

(a) The applicability of the separate share rule provided by section 663(c) to trusts other than qualified revocable trusts within the meaning of section 645(b)(1) will generally depend upon whether distributions of the trust are to be made in substantially the same manner as if separate trusts had been created. Thus, if an instrument directs a trustee to divide the testator's residuary estate into separate shares (which under applicable law do not constitute separate trusts) for each of the testator's children and the trustee is