

§ 1.668(b)-1A

§ 1.668(b)-1A Tax on distribution.

(a) *In general.* The partial tax imposed on the beneficiary by section 668(a)(2) shall be the lesser of:

(1) The tax computed under paragraph (b) of this section (the "exact" method), or

(2) The tax computed under paragraph (c) of this section (the "short-cut" method),

except as provided in § 1.668(b)-4A (relating to failure to furnish proper information) and paragraph (d) of this section (relating to disallowance of short-cut method). For purposes of this paragraph, the method used in the return shall be accepted as the method that produces the lesser tax. The beneficiary's choice of the two methods is not dependent upon the method that he uses to compute his partial tax imposed by section 668(a)(3).

(b) *Computation of partial tax by the exact method.* The partial tax referred to in paragraph (a)(1) of this section is computed as follows:

(1) First, compute the tax attributable to the section 666 amounts for each of the preceding taxable years. For purposes of this paragraph, the "section 666 amounts" for a preceding taxable year are the amounts deemed distributed under section 666(a) on the last day of the preceding taxable year, plus the amount of taxes deemed distributed on such day under section 666 (b) or (c). The tax attributable to such amounts in each prior taxable year of the beneficiary is the difference between the tax for such year computed with the inclusion of the section 666 amounts in the beneficiary's gross income and the tax for such year computed without including them in such gross income. Tax computations for each such year shall reflect a taxpayer's marital, dependency, exemption, and filing status for such year. To the extent the undistributed net income of a trust deemed distributed in an accumulation distribution includes amounts received as an accumulation distribution from another trust, for purposes of this paragraph they shall be considered as amounts deemed distributed by the trust under section 666(a) on the last day of each of the preceding taxable years in which such amounts were accumulated by such

other trust. For example, assume trust Z, a calendar year trust, received in its taxable year 1975 an accumulation distribution from trust Y, a calendar year trust, that included undistributed net income and taxes of trust Y for the taxable years 1972, 1973, and 1974. To the extent an accumulation distribution made by trust Z in its taxable year 1976 includes such undistributed net income and taxes, it shall be considered an accumulation distribution by trust Z in the taxable year 1976 and under section 666(a) will be deemed distributed on the last day of the preceding taxable years 1972, 1973, and 1974.

(2) From the sum of the taxes for the prior taxable years attributable to the section 666 amounts (computed in accordance with subparagraph (1) of this paragraph), subtract so much of the amount of taxes deemed distributed to the beneficiary under §§ 1.666(b)-1A and 1.666(c)-1A as does not exceed such sum. The resulting amount, if any, is the partial tax, computed under the exact method, for the taxable year in which the accumulation distribution is paid, credited, or required to be distributed to the beneficiary.

(3) The provisions of this paragraph may be illustrated by the following example:

Example. (i) Assume that in 1979 a trust makes an accumulation distribution of \$15,000 to A. The accumulation distribution is allocated under section 666(a) in the amounts of \$5,000 to 1971, \$4,000 to 1972, and \$6,000 to 1973. Under section 666 (b) and (c), taxes in the amounts of \$935, \$715, and \$1,155 (totaling \$2,805) are deemed distributed in 1971, 1972, and 1973, respectively.

(ii) A, the beneficiary, had taxable income and paid income tax in 1971-73 as follows:

Year	Taxable income	Tax
1971	\$10,000	\$2,190
1972	12,000	2,830
1973	14,000	3,550

(iii) Taxes attributable to the section 666 amounts (paragraph (i) of this example) are \$6,979, computed as follows:

1971	
Taxable income including section 666 amounts (\$10,000 + \$5,000 + \$935)	\$15,935
Tax on \$15,935	\$4,305
Less: Tax paid by A in 1971	2,190
Tax attributable to 1971 section 666 amounts	2,115

Internal Revenue Service, Treasury

§ 1.668(b)-1A

1972	
Taxable income including section 666 amounts (\$12,000 + \$4,000 + \$715)	\$16,715
Tax on \$16,715	\$4,620
Less: Tax paid by A in 1972	2,830
Tax attributable to 1972 section 666 amounts	1,790
1973	
Taxable income including section 666 amounts (\$14,000 + \$6,000 + \$1,155)	\$21,155
Tax on \$21,155	\$6,624
Less: Tax paid by A in 1973	3,550
Tax attributable to 1973 section 666 amounts	3,074
Total tax attributable to section 666 amounts:	
1971	\$2,115
1972	1,790
1973	3,074
Total	6,979

(iv) The partial tax computed under the exact method is \$4,174, computed by subtracting the taxes deemed distributed (\$2,805) from the tax attributable to the section 666 amounts (\$6,979).

(c) *Computation of tax by the short-cut method.* (1) The tax referred to in paragraph (a)(2) of this section is computed as follows:

(i) First, determine the number of preceding taxable years of the trust on the last day of which an amount is deemed under section 666(a) to have been distributed. For purposes of the preceding sentence, the preceding taxable years of a trust that has received an accumulation distribution from another trust shall include the taxable years of such other trust in which an amount was deemed distributed in such accumulation distribution. For example, assume trust Z, a calendar year trust, received in its taxable year 1975 an accumulation distribution from trust Y, a calendar year trust, that included undistributed net income of trust Y for the taxable years 1972, 1973, and 1974. To the extent an accumulation distribution made by trust Z in its taxable year 1976 includes such undistributed net income, it shall be considered an accumulation distribution by trust Z in the taxable year 1976 and under section 666(a) will be deemed distributed on the last day of the preceding taxable years 1972, 1973, and 1974. For purposes of this subparagraph, such number of preceding taxable years of the trust shall not include any preceding taxable year of the trust in which the undistributed net income

deemed distributed is less than 25 percent of (a) the total amounts deemed under section 666(a) to be undistributed net income from preceding taxable years divided by (b) the number of such preceding taxable years of the trust on the last day of which an amount is deemed under section 666(a) to have been distributed without application of this sentence. For example, assume that an accumulation distribution of \$90,000 made to a beneficiary in 1979 is deemed distributed in the amounts of \$29,000 in each of the years 1972, 1973, and 1974, and \$3,000 in 1975. The number of preceding taxable years on the last day of which an amount was deemed distributed without reference to the second sentence of this subparagraph is four. However, the distribution deemed made in 1975 (\$3,000) is less than \$5,625, which is 25 percent of (a) the total undistributed net income deemed distributed under section 666(a) (\$90,000) divided by (b) the number of such preceding taxable years (4), or \$22,500. Therefore, for purposes of this subparagraph the accumulation distribution is deemed distributed in only 3 preceding taxable years (1972, 1973, and 1974).

(ii) Second, divide the amount (representing the accumulation distribution and taxes deemed distributed) required under section 668(a) to be included in the income of the beneficiary for the taxable year by the number of preceding taxable years of the trust on the last day of which an amount is deemed under section 666(a) to have been distributed (determined as provided in subdivision (i) of this subparagraph). The amount determined under this subdivision, including taxes deemed distributed, consists of the same proportion of each class of income as the total of each class of income deemed distributed in the accumulation distribution bears to the total undistributed net income from such preceding taxable years deemed distributed in the accumulation distribution. For example, assume that an amount of \$50,000 is deemed distributed under section 666(a) from undistributed net income of 5 preceding taxable years of the trust, and consists of \$25,000 of interest, \$15,000 of dividends, and \$10,000 of net rental income. Taxes attributable to such amounts in the

§ 1.668(b)-1A

amount of \$10,000 are also deemed distributed. The amount determined under this subdivision, \$12,000 (\$50,000 income plus \$10,000 tax divided by 5 years), is deemed to consist of \$6,000 in interest, \$3,600 in dividends, and \$2,400 in net rental income.

(iii) Third, compute the tax of the beneficiary for each of the 3 taxable years immediately preceding the year in which the accumulation distribution is paid, credited, or required to be distributed to him,

(a) With the inclusion in gross income of the beneficiary for each of such 3 years of the amount determined under subdivision (ii) of this subparagraph, and

(b) Without such inclusion.

The difference between the amount of tax computed under (a) of this subdivision for each year and the amount computed under (b) of this subdivision for that year is the additional tax resulting from the inclusion in gross income for that year of the amount determined under subdivision (ii) of this subparagraph. For example, assume that a distribution of \$12,000, is includible in the income of each of the beneficiary's 3 preceding taxable years when his income (without the inclusion of the accumulation distribution) was \$20,000, \$30,000, and \$40,000. The inclusion of \$12,000 in income would produce taxable income of \$32,000, \$42,000, and \$52,000, and the tax attributable to such increases would be \$4,000, \$5,000, and \$6,000, respectively.

(iv) Fourth, add the additional taxes resulting from the application of subdivision (iii) of this subparagraph and then divide this amount by 3. For example, if these additional taxes are \$4,000, \$5,000, and \$6,000 for the 3 preceding taxable years, this amount would be \$5,000 (\$4,000+\$5,000+ \$6,000 divided by 3).

(v) Fifth, the resulting amount is then multiplied by the number of preceding taxable years of the trust on the last day of which an amount is deemed under section 666(a) to have been distributed (previously determined under subdivision (i) of this subparagraph). For example, if an amount is deemed distributed for 5 preceding taxable years, the resulting amount would be five times the \$5,000 amount.

(vi) Sixth, the resulting amount, less so much of the amount of taxes deemed distributed to the beneficiary under §§ 1.666(b)-1A and 1.666(c)-1A as does not exceed such resulting amount, is the tax under the short-cut method provided in section 668(b)(1)(B).

(2) The computation of the tax by the short-cut method may be illustrated by the following example:

Example: In 1971, X creates a trust which is to accumulate its income and pay the income to Y when Y reaches 30. Y is 19. Over the 11 years of the trust, the trust earns \$1,200 of interest income annually and has expenses each year of \$100 allocable to the production of income. The trust pays a total tax of \$1,450 on the accumulated income. In 1981, when Y reaches 30, the \$9,550 of accumulated undistributed net income and the \$1,100 of current net income are distributed to Y. Y is treated as having received a total distribution of \$11,000 (the \$9,550 accumulation distribution plus the taxes paid by the trust which are deemed to have been distributed to Y). The income of the current year (1981) is taxed directly to Y. The computation is as follows: \$11,000 (accumulation distribution plus taxes) divided by 10 (number of years out of which distribution was made) equals \$1,100. The \$1,100 added to the income of the beneficiary's preceding 3 years produces increases in tax as follows:

1980	\$350
1979	300
1978	250
Total	<u>900</u>

\$900 (total additional tax) divided by 3 equals \$300 (average annual increase in tax). \$300 (average annual increase in tax) times 10 equals \$3,000, from which is deducted the amount of taxes (\$1,450) paid by the trust attributable to the undistributed net income deemed distributed. The amount of tax to be paid currently under the short-cut method is therefore \$1,550.

(d) *Disallowance of short-cut method.* If, in any prior taxable year of the beneficiary in which any part of the accumulation distribution of undistributed net income is deemed to have been distributed under section 666(a) to such beneficiary, any part of prior accumulation distributions of undistributed net income by each of two or more other trusts is deemed under section 666(a) to have been distributed to such beneficiary, then the short-cut method under paragraph (c) of this section may not be used and the partial tax imposed by section 668(a)(2) shall be computed

only under the exact method under paragraph (b) of this section. For example, assume that, in 1978, trust X makes an accumulation distribution of undistributed net income to A, who is on the calendar year basis, and part of the accumulation distribution is deemed under section 666(a) to have been distributed on March 31, 1974. In 1977, A had received an accumulation distribution of undistributed net income from both trust Y and trust Z. Part of the accumulation distribution from trust Y was deemed under section 666(a) to have been distributed to A on June 30, 1974, and part of the accumulation distribution from trust Z was deemed under section 666(a) to have been distributed to A on December 31, 1974. Because there were portions of accumulation distributions of undistributed net income from two other trusts deemed distributed within the same prior taxable year of A (1974), the 1978 accumulation distribution from trust X may not be computed under the shortcut method provided in paragraph (c) of this section. Therefore the exact method under paragraph (b) of this section must be used to compute the tax imposed by section 666(a)(2).

[T.D. 7204, 37 FR 17149, Aug. 25, 1972]

§ 1.668(b)-2A Special rules applicable to section 668.

(a) *Rule when beneficiary not in existence on the last day of a taxable year.* If a beneficiary was not in existence on the last day of a preceding taxable year of the trust with respect to which a distribution is deemed made under section 666(a), it shall be assumed, for purposes of the computations under paragraphs (b) and (c) of § 1.668(b)-1A, that the beneficiary:

- (1) Was in existence on such last day,
- (2) Was a calendar year taxpayer,
- (3) Had no gross income other than the amounts deemed distributed to him from such trust in his calendar year in which such last day occurred and from all other trusts from which amounts are deemed to have been distributed to him in such calendar year,
- (4) If an individual, was unmarried and had no dependents,
- (5) Had no deductions other than the standard deduction, if applicable, under section 141 for such calendar year, and

(6) Was entitled to the personal exemption under section 151 or 642(b).

For example, assume that part of an accumulation distribution made in 1980 is deemed under section 666(a) to have been distributed to the beneficiary, A, in 1973; \$10,000 of a prior accumulation distribution was deemed distributed in 1973. A was born on October 9, 1975. It will be assumed for purposes of § 1.668(b)-1A that A was alive in 1973, was on the calendar year basis, had no income other than (i) the \$10,000 from the earlier accumulation distribution deemed distributed in 1973, and (ii) the part of the 1980 distribution deemed distributed in 1973, and had no deductions other than the personal exemption provided in section 151. It should be noted that the standard deduction for 1973 will be available to A with respect to the distribution only to the extent it qualifies as "earned income" in the hands of the trust. See section 141(e) and the regulations thereunder and § 1.652(b)-1. If A were a trust or estate created after 1973, the same assumptions would apply, except that the trust or estate would not be entitled to the standard deduction and would receive the personal exemption provided under section 642(b) in the same manner as allowed under such section for A's first actual taxable year.

(b) *Effect of other distributions.* The income of the beneficiary, for any of his prior taxable years for which a tax is being recomputed under § 1.668(b)-1A, shall include any amounts of prior accumulation distributions (including prior capital gain distributions) deemed distributed under sections 666 and 669 in such prior taxable year. For purposes of the preceding sentence, a "prior accumulation distribution" is a distribution from the same or another trust which was paid, credited, or required to be distributed in a prior taxable year of the beneficiary. The term "prior accumulation distribution" also includes accumulation distributions of other trusts which were paid, credited, or required to be distributed to the beneficiary in the same taxable year and which the beneficiary has determined under paragraph (c) of this section to treat as having been distributed before the accumulation distribution for which tax is being computed under