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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.

§ 1.652(c)-4 Illustration of the provisions of sections 651 and 652.

The rules applicable to a trust required to distribute all of its income currently to its beneficiaries may be illustrated by the following example:

Example. (a) Under the terms of a simple trust all of the income is to be distributed equally to beneficiaries A and B and capital gains are to be allocated to corpus. The trust and both beneficiaries file returns on the calendar year basis. No provision is made in the governing instrument with respect to depreciation. During the taxable year 1955, the trust had the following items of income and expense:

Rents	\$25,000
Dividends of domestic corporations	50,000
Tax-exempt interest on municipal bonds	25,000
Long-term capital gains	15,000
Taxes and expenses directly attributable to rents	5,000
Trustee's commissions allocable to income account	2,600
Trustee's commissions allocable to principal account	1,300

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Depreciation 5,000

(b) The income of the trust for fiduciary accounting purposes is \$92,400, computed as follows:

Rents	\$25,000	
Dividends	50,000	
Tax-exempt interest	25,000	
Total	100,000	
Deductions:		
Expenses directly attributable to rental income	\$5,000	
Trustee's commissions allocable to income account	2,600	
		7,600
Income computed under section 643(b)	92,400	

One-half (\$46,200) of the income of \$92,400 is currently distributable to each beneficiary.

(c) The distributable net income of the trust computed under section 643(a) is \$91,100, determined as follows (cents are disregarded in the computation):

Rents	\$25,000	
Dividends	50,000	
Tax-exempt interest	\$25,000	
Less: Expenses allocable thereto (25,000/100,000 x \$3,900)	975	
		24,025
Total	99,025	
Deductions:		
Expenses directly attributable to rental income	\$5,000	
Trustee's commissions (\$3,900 less \$975 allocable to tax-exempt interest)	2,925	
		7,925
Distributable net income	91,100	

In computing the distributable net income of \$91,100, the taxable income of the trust was computed with the following modifications: No deductions were allowed for distributions to the beneficiaries and for personal exemption of the trust (section 643(a) (1) and (2)); capital gains were excluded and no deduction under section 1202 (relating to the 50-percent deduction for long-term capital gains) was taken into account (section 643(a)(3)); the tax-exempt interest (as adjusted for expenses) and the dividend exclusion of \$50 were included (section 643(a) (5) and (7)). Since all of the income of the trust is re-

quired to be currently distributed, no deduction is allowable for depreciation in the absence of specific provisions in the governing instrument providing for the keeping of the trust corpus intact. See section 167(h) and the regulations thereunder.

(d) The deduction allowable to the trust under section 651(a) for distributions to the beneficiaries is \$67,025, computed as follows:

Distributable net income computed under section 643(a) (see paragraph (c))	\$91,100	
Less:		
Tax-exempt interest as adjusted	\$24,025	
Dividend exclusion	50	
		24,075
Distributable net income as determined under section 651(b)	67,025	

Since the amount of the income (\$92,400) required to be distributed currently by the trust exceeds the distributable net income (\$67,025) as computed under section 651(b), the deduction allowable under section 651(a) is limited to the distributable net income of \$67,025.

(e) The taxable income of the trust is \$7,200 computed as follows:

Rents	\$25,000	
Dividends (\$50,000 less \$50 exclusion)	49,950	
Long-term capital gains	15,000	
Gross income	89,950	
Deductions:		
Rental expenses	\$5,000	
Trustee's commissions	2,925	
Capital gain deduction	7,500	
Distributions to beneficiaries	67,025	
Personal exemption	300	
		82,750
Taxable income	7,200	

The trust is not allowed a deduction for the portion (\$975) of the trustee's commissions allocable to tax-exempt interest in computing its taxable income.

(f) In determining the character of the amounts includible in the gross income of A and B, it is assumed that the trustee elects to allocate to rents the expenses not directly attributable to a specific item of income other than the portion (\$975) of such expenses allocated to tax-exempt interest. The allocation of expenses among the items of income is shown below:

	Rents	Dividends	Tax-exempt interest	Total
Income for trust accounting purposes	\$25,000	\$50,000	\$25,000	\$100,000
Less:				
Rental expenses	5,000			5,000
Trustee's commissions	2,925		975	3,900
Total deductions	7,925	0	975	8,900
Character of amounts in the hands of the beneficiaries	17,075	50,000	24,025	¹91,100

¹ Distributable net income.

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Inasmuch as the income of the trust is to be distributed equally to A and B, each is deemed to have received one-half of each item of income; that is, rents of \$8,537.50, dividends of \$25,000, and tax-exempt interest of \$12,012.50. The dividends of \$25,000 allocated to each beneficiary are to be aggregated with his other dividends (if any) for purposes of the dividend exclusion provided by section 116 and the dividend received credit allowed under section 34. Also, each beneficiary is allowed a deduction of \$2,500 for depreciation of rental property attributable to the portion (one-half) of the income of the trust distributed to him.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 6712, 29 FR 3655, Mar. 24, 1964]

ESTATES AND TRUSTS WHICH MAY ACCUMULATE INCOME OR WHICH DISTRIBUTE CORPUS

§ 1.661(a)-1 Estates and trusts accumulating income or distributing corpus; general.

Subpart C, part I, subchapter J, chapter 1 of the Code, is applicable to all decedents' estates and their beneficiaries, and to trusts and their beneficiaries other than trusts subject to the provisions of subpart B of such part I (relating to trusts which distribute current income only, or "simple" trusts). A trust which is required to distribute amounts other than income during the taxable year may be subject to subpart B, and not subpart C, in the absence of an actual distribution of amounts other than income during the taxable year. See §§ 1.651(a)-1 and 1.651(a)-3. A trust to which subpart C is applicable is referred to as a "complex" trust in this part. Section 661 has no application to amounts excluded under section 663(a).

§ 1.661(a)-2 Deduction for distributions to beneficiaries.

(a) In computing the taxable income of an estate or trust there is allowed under section 661(a) as a deduction for distributions to beneficiaries the sum of:

(1) The amount of income for the taxable year which is required to be distributed currently, and

(2) Any other amounts properly paid or credited or required to be distributed for such taxable year.

However, the total amount deductible under section 661(a) cannot exceed the distributable net income as computed under section 643(a) and as modified by section 661(c). See § 1.661(c)-1.

(b) The term *income required to be distributed currently* includes any amount required to be distributed which may be paid out of income or corpus (such as an annuity), to the extent it is paid out of income for the taxable year. See § 1.651(a)-2 which sets forth additional rules which are applicable in determining whether income of an estate or trust is required to be distributed currently.

(c) The term *any other amounts properly paid, credited, or required to be distributed* includes all amounts properly paid, credited, or required to be distributed by an estate or trust during the taxable year other than income required to be distributed currently. Thus, the term includes the payment of an annuity to the extent it is not paid out of income for the taxable year, and a distribution of property in kind (see paragraph (f) of this section). However, see section 663(a) and regulations thereunder for distributions which are not included. Where the income of an estate or trust may be accumulated or distributed in the discretion of the fiduciary, or where the fiduciary has a power to distribute corpus to a beneficiary, any such discretionary distribution would qualify under section 661(a)(2). The term also includes an amount applied or distributed for the support of a dependent of a grantor or of a trustee or cotrustee under the circumstances described in section 677(b) or section 678(c) out of corpus or out of other than income for the taxable year.

(d) The terms *income required to be distributed currently* and *any other amounts properly paid or credited or required to be distributed* also include any amount used to discharge or satisfy any person's legal obligation as that term is used in § 1.662(a)-4.

(e) The terms *income required to be distributed currently* and *any other amounts properly paid or credited or required to be distributed* include amounts paid, or required to be paid, during the taxable year pursuant to a court order or decree or under local law, by a decedent's estate as an allowance or award