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which the estate was allowed a deduction under section 661(a). The application of this paragraph may be illustrated by the following examples:

Example 1. By his will D creates a trust for his widow W. The terms of the trust require that the income be distributed currently (i.e., it is a simple trust), and authorize the trustee to make discretionary payments of corpus to W. Upon W's death the trust corpus is to be distributed to D's then living issue. The executor of D's will makes a $10,000 distribution of corpus to the trust that carries out estate income consisting of dividends and interest to the trust under section 665(a)(2). The trust reports this income as its only income on its income tax return for its taxable year in which the distribution of the corpus to D's issue occurred as a result of the estate income consisting of dividends and interest to the trust that carries out estate income consisting of dividends and interest to the trust under section 665(a)(2). Thus, the trust has undistributed net income of $7,894 ($10,000 - $2,106). Several years later the trust makes a discretionary corpus payment of $15,000 to W. This payment is an accumulation distribution under section 665(b). However, since the trust had no “outside income” in the year of the estate distribution, such year is not a preceding taxable year. Thus, W is not treated as receiving undistributed net income of $7,894 and taxes thereon of $2,106 for the purpose of including the same in her gross income under section 668. The result would be the same if the invasion power were not exercised and the accumulation distribution occurred as a result of the distribution of the corpus to D's issue upon the death of W.

Example 2. Trust A, a simple trust on the calendar year basis, received in 1972 extraordinary dividends or taxable stock dividends that the trustee in good faith allocated to corpus and not paid, but that are determined in 1974 to constitute corpus (i.e., it is a simple trust), to the beneficiary. See section 643(a)(4) and §1.643(a)-3. The balance of the capital gain is included in distributable net income under section 643(a)(3) and §1.643(a)-3.

(ii) The amount of such gains that are included in distributable net income under section 643(a)(3) and §1.643(a)-3.

(iii) In the case of a trust that does not use the alternative method for computing taxes on capital gains of the taxable year, the excess of deductions over capital losses, shall be taken into account.

The application of this subparagraph may be illustrated by the following example:

Example. Under the terms of the trust, the trustee must distribute all income currently and has discretion to distribute capital gain to A or to allocate it to corpus. During the taxable year 1971 the trust recognized capital gain in the amount of $15,000, and capital losses of $5,000, and had interest income (after expenses) of $6,000. The trustee distributed $8,000 to A, consisting of $6,000 of interest and $2,000 of capital gain. The $2,000 of gain distributed to A is included in the computation of distributable net income under §1.643(a)-3. The balance of the capital gain is not included in distributable net income since it is allocated to corpus and not paid, credited, or required to be distributed to any beneficiary. The trust paid taxes of $671, all
§ 1.665(g)–1A Capital gain distribution.

For any taxable year of a trust, the term capital gain distribution means, to the extent of the undistributed capital gain of the trust, that portion of an accumulation distribution that exceeds the amount of such accumulation distribution deemed under section 666(a) to be undistributed net income of the trust for all preceding taxable years. See § 1.665(b)–1A for the definition of “accumulation distribution”. For any such taxable year the undistributed capital gain includes the total undistributed capital gain for all years of the trust beginning with the first taxable year beginning after December 31, 1968, in which income (as determined under section 643(b)) is accumulated, and ending before such taxable year. See § 1.665(g)–2A for application of the separate share rule. The application of this section may be illustrated by the following example:

Example. A trust on the calendar year basis made the following accumulations. For purposes of this example, the undistributed net income is the same as income under applicable local law. No income was accumulated prior to 1970.

<table>
<thead>
<tr>
<th>Year</th>
<th>Undistributed net income</th>
<th>Undistributed capital gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>None</td>
<td>$10,000</td>
</tr>
<tr>
<td>1970</td>
<td>$1,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>1971</td>
<td>None</td>
<td>$4,000</td>
</tr>
</tbody>
</table>

The trust has distributable net income in 1972 of $2,000 and recognizes capital gains of $4,500 that are allocable to corpus. On December 31, 1972, the trustee makes a distribution of $20,000 to the beneficiary. There is an accumulation distribution of $18,000 ($20,000 distribution less $2,000 d.n.i.) that consists of undistributed net income of $1,000 (see § 1.666(a)–1A) and a capital gain distribution of $7,000. The capital gain distribution is computed as follows:

Accumulation distribution ........................................ $18,000
Less: Undistributed net income .................................. 1,000
Balance ........................................................................ 17,000

Capital gain distribution (undistributed capital gain of the trust for 1972 ($3,000 from 1970 and $4,000 from 1971)) ................................................. 7,000
Balance (corpus) ......................................................... 10,000

No undistributed capital gain is deemed distributed from 1969 because 1969 is a year prior to the first year in which income is accumulated (1970). The accumulation distribution is not deemed to consist of any part of the capital gains recognized in 1972.

[T.D. 7204, 37 FR 17142, Aug. 25, 1972]