

beneficiary from such share, an accumulation distribution will be deemed to have been made to the extent of such amount. In determining the distributable net income of such share, only those items of income and deduction for the taxable year of the trust in which such share terminates, properly allocable to such share, shall be taken into consideration.

(2) No accumulation distribution will be deemed to have been made upon the termination of a separate share to the extent that the property constituting such share, or a portion thereof, continues to be held as a part of the same trust. The undistributed net income, undistributed capital gain, and the taxes imposed on the trust attributable to such items, if any, for all preceding taxable years (reduced by any amounts deemed distributed under sections 666(a) and 669(a) by reason of any accumulation distribution of undistributed net income or undistributed capital gain in prior years or the current taxable year), which were allocable to the terminating share, shall be treated as being applicable to the trust itself. However, no adjustment will be made to the amounts deemed distributed under sections 666 and 669 by reason of an accumulation distribution of undistributed net income or undistributed capital gain from the surviving share or shares made in years prior to the year in which the terminating share was added to such surviving share or shares.

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

*Example.* A trust was established under the will of X for the benefit of his wife and upon her death the property was to continue in the same trust for his two sons, Y and Z. The separate share rule is applicable to this trust. The trustee had discretion to pay or accumulate the income to the wife, and after her death was to pay each son's share to him after he attained the age of 25. When the wife died, Y was 23 and Z was 28.

(1) Upon the death of X's widow, there is no accumulation distribution. The entire trust is split into two equal shares, and therefore the undistributed net income and the undistributed capital gain of the trust are split into two shares.

(2) The distribution to Z of his share after his mother's death is an accumulation distribution of his separate share of one-half of

the undistributed net income and undistributed capital gain.

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

GRANTORS AND OTHERS TREATED AS  
SUBSTANTIAL OWNERS

**§ 1.671-1 Grantors and others treated as substantial owners; scope.**

(a) Subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Code, contains provisions taxing income of a trust to the grantor or another person under certain circumstances even though he is not treated as a beneficiary under subparts A through D (section 641 and following) of such part I. Sections 671 and 672 contain general provisions relating to the entire subpart. Sections 673 through 677 define the circumstances under which income of a trust is taxed to a grantor. These circumstances are in general as follows:

(1) If the grantor has retained a reversionary interest in the trust, within specified time limits (section 673);

(2) If the grantor or a nonadverse party has certain powers over the beneficial interests under the trust (section 674);

(3) If certain administrative powers over the trust exist under which the grantor can or does benefit (section 675).

(4) If the grantor or a nonadverse party has a power to revoke the trust or return the corpus to the grantor (section 676); or

(5) If the grantor or a nonadverse party has the power to distribute income to or for the benefit of the grantor or the grantor's spouse (section 677).

Under section 678, income of a trust is taxed to a person other than the grantor to the extent that he has the sole power to vest corpus or income in himself.

(b) Sections 671 through 677 do not apply if the income of a trust is taxable to a grantor's spouse under section 71 or 682 (relating respectively to alimony and separate maintenance payments, and the income of an estate or trust in the case of divorce, etc.).

## § 1.671-2

(c) Except as provided in such subpart E, income of a trust is not included in computing the taxable income and credits of a grantor or another person solely on the grounds of his dominion and control over the trust. However, the provisions of subpart E do not apply in situations involving an assignment of future income, whether or not the assignment is to a trust. Thus, for example, a person who assigns his right to future income under an employment contract may be taxed on that income even though the assignment is to a trust over which the assignor has retained none of the controls specified in sections 671 through 677. Similarly, a bondholder who assigns his right to interest may be taxed on interest payments even though the assignment is to an uncontrolled trust. Nor are the rules as to family partnerships affected by the provisions of subpart E, even though a partnership interest is held in trust. Likewise, these sections have no application in determining the right of a grantor to deductions for payments to a trust under a transfer and leaseback arrangement. In addition, the limitation of the last sentence of section 671 does not prevent any person from being taxed on the income of a trust when it is used to discharge his legal obligation. See § 1.662(a)-4. He is then treated as a beneficiary under subparts A through D or treated as an owner under section 677 because the income is distributed for his benefit, and not because of his dominion or control over the trust.

(d) The provisions of subpart E are not applicable with respect to a pooled income fund as defined in paragraph (5) of section 642(c) and the regulations thereunder, a charitable remainder annuity trust as defined in paragraph (1) of section 664(d) and the regulations thereunder, or a charitable remainder unitrust as defined in paragraph (2) of section 664(d) and the regulations thereunder.

(e) For the effective date of subpart E see section 683 and the regulations thereunder.

(f) For rules relating to the treatment of liabilities resulting on the sale or other disposition of encumbered trust property due to a renunciation of

## 26 CFR Ch. I (4-1-12 Edition)

powers by the grantor or other owner, see § 1.1001-2.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7148, 36 FR 20749, Oct. 29, 1971; T.D. 7741, 45 FR 81745, Dec. 12, 1980]

### § 1.671-2 Applicable principles.

(a) Under section 671 a grantor or another person includes in computing his taxable income and credits those items of income, deduction, and credit against tax which are attributable to or included in any portion of a trust of which he is treated as the owner. Sections 673 through 678 set forth the rules for determining when the grantor or another person is treated as the owner of any portion of a trust. The rules for determining the items of income, deduction, and credit against tax that are attributable to or included in a portion of the trust are set forth in § 1.671-3.

(b) Since the principle underlying subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Code, is in general that income of a trust over which the grantor or another person has retained substantial dominion or control should be taxed to the grantor or other person rather than to the trust which receives the income or to the beneficiary to whom the income may be distributed, it is ordinarily immaterial whether the income involved constitutes income or corpus for trust accounting purposes. Accordingly, when it is stated in the regulations under subpart E that “income” is attributed to the grantor or another person, the reference, unless specifically limited, is to income determined for tax purposes and not to income for trust accounting purposes. When it is intended to emphasize that income for trust accounting purposes (determined in accordance with the provisions set forth in § 1.643(b)-1 is meant, the phrase “ordinary income” is used.

(c) An item of income, deduction, or credit included in computing the taxable income and credits of a grantor or another person under section 671 is treated as if it had been received or paid directly by the grantor or other person (whether or not an individual). For example, a charitable contribution made by a trust which is attributed to the grantor (an individual) under sections 671 through 677 will be aggregated

with his other charitable contributions to determine their deductibility under the limitations of section 170(b)(1). Likewise, dividends received by a trust from sources in a particular foreign country which are attributed to a grantor or another person under subpart E will be aggregated with his other income from sources within that country to determine whether the taxpayer is subject to the limitations of section 904 with respect to credit for the tax paid to that country.

(d) Items of income, deduction, and credit not attributed to or included in any portion of a trust of which the grantor or another person is treated as the owner under subpart E are subject to the provisions of subparts A through D (section 641 and following), of such part I.

(e)(1) For purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer (within the meaning of paragraph (e)(2) of this section) of property to a trust. For purposes of this section, the term *property* includes cash. If a person creates or funds a trust on behalf of another person, both persons are treated as grantors of the trust. (See section 6048 for reporting requirements that apply to grantors of foreign trusts.) However, a person who creates a trust but makes no gratuitous transfers to the trust is not treated as an owner of any portion of the trust under sections 671 through 677 or 679. Also, a person who funds a trust with an amount that is directly reimbursed to such person within a reasonable period of time and who makes no other transfers to the trust that constitute gratuitous transfers is not treated as an owner of any portion of the trust under sections 671 through 677 or 679. See also §1.672(f)-5(a).

(2)(i) A gratuitous transfer is any transfer other than a transfer for fair market value. A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is treated as a gift for gift tax purposes.

(ii) For purposes of this paragraph (e), a transfer is for fair market value

only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust. For example, rents, royalties, interest, and compensation paid to a trust are transfers for fair market value only to the extent that the payments reflect an arm's length price for the use of the property of, or for the services rendered by, the trust. For purposes of this determination, an interest in the trust is not property received from the trust. In addition, a person will not be treated as making a transfer for fair market value merely because the transferor recognizes gain on the transaction. See, for example, section 684 regarding the recognition of gain on certain transfers to foreign trusts.

(iii) For purposes of this paragraph (e), a gratuitous transfer does not include a distribution to a trust with respect to an interest held by such trust in either a trust described in paragraph (e)(3) of this section or an entity other than a trust.

For example, a distribution to a trust by a corporation with respect to its stock described in section 301 is not a gratuitous transfer.

(3) A grantor includes any person who acquires an interest in a trust from a grantor of the trust if the interest acquired is an interest in certain investment trusts described in §301.7701-4(c) of this chapter, liquidating trusts described in §301.7701-4(d) of this chapter, or environmental remediation trusts described in §301.7701-4(e) of this chapter.

(4) If a gratuitous transfer is made by a partnership or corporation to a trust and is for a business purpose of the partnership or corporation, the partnership or corporation will generally be treated as the grantor of the trust. For example, if a partnership makes a gratuitous transfer to a trust in order to secure a legal obligation of the partnership to a third party unrelated to the partnership, the partnership will be treated as the grantor of the trust. However, if a partnership or a corporation makes a gratuitous transfer to a trust that is not for a business purpose of the partnership or corporation but is for the personal purposes of one or more of the partners or shareholders,

the gratuitous transfer will be treated as a constructive distribution to such partners or shareholders under federal tax principles and the partners or the shareholders will be treated as the grantors of the trust. For example, if a partnership makes a gratuitous transfer to a trust that is for the benefit of a child of a partner, the gratuitous transfer will be treated as a distribution to the partner under section 731 and a subsequent gratuitous transfer by the partner to the trust.

(5) If a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust. However, if a person with a general power of appointment over the transferor trust exercises that power in favor of another trust, then such person will be treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code.

(6) The following examples illustrate the rules of this paragraph (e). Unless otherwise indicated, all trusts are domestic trusts, and all other persons are United States persons. The examples are as follows:

*Example 1.* A creates and funds a trust, T, for the benefit of her children. B subsequently makes a gratuitous transfer to T. Under paragraph (e)(1) of this section, both A and B are grantors of T.

*Example 2.* A makes an investment in a fixed investment trust, T, that is classified as a trust under §301.7701-4(c)(1) of this chapter. A is a grantor of T. B subsequently acquires A's entire interest in T. Under paragraph (e)(3) of this section, B is a grantor of T with respect to such interest.

*Example 3.* A, an attorney, creates a foreign trust, FT, on behalf of A's client, B, and transfers \$100 to FT out of A's funds. A is reimbursed by B for the \$100 transferred to FT. The trust instrument states that the trustee has discretion to distribute the income or corpus of FT to B and B's children. Both A and B are treated as grantors of FT under paragraph (e)(1) of this section. In addition, B is treated as the owner of the entire trust under section 677. Because A is reimbursed for the \$100 transferred to FT on behalf of B, A is not treated as transferring any property to FT. Therefore, A is not an owner of any portion of FT under sections 671 through 677 regardless of whether A retained any power

over or interest in FT described in sections 673 through 677. Furthermore, A is not treated as an owner of any portion of FT under section 679. Both A and B are responsible parties for purposes of the requirements in section 6048.

*Example 4.* A creates and funds a trust, T. A does not retain any power or interest in T that would cause A to be treated as an owner of any portion of the trust under sections 671 through 677. B holds an unrestricted power, exercisable solely by B, to withdraw certain amounts contributed to the trust before the end of the calendar year and to vest those amounts in B. B is treated as an owner of the portion of T that is subject to the withdrawal power under section 678(a)(1). However, B is not a grantor of T under paragraph (e)(1) of this section because B neither created T nor made a gratuitous transfer to T.

*Example 5.* A transfers cash to a trust, T, through a broker, in exchange for units in T. The units in T are not property for purposes of determining whether A has received fair market value under paragraph (e)(2)(ii) of this section. Therefore, A has made a gratuitous transfer to T, and, under paragraph (e)(1) of this section, A is a grantor of T.

*Example 6.* A borrows cash from T, a trust. A has not made any gratuitous transfers to T. A's length interest payments by A to T will not be treated as gratuitous transfers under paragraph (e)(2)(ii) of this section. Therefore, under paragraph (e)(1) of this section, A is not a grantor of T with respect to the interest payments.

*Example 7.* A, B's brother, creates a trust, T, for B's benefit and transfers \$50,000 to T. The trustee invests the \$50,000 in stock of Company X. C, B's uncle, purportedly sells property with a fair market value of \$1,000,000 to T in exchange for the stock when it has appreciated to a fair market value of \$100,000. Under paragraph (e)(2)(ii) of this section, the \$900,000 excess value is a gratuitous transfer by C. Therefore, under paragraph (e)(1) of this section, A is a grantor with respect to the portion of the trust valued at \$100,000, and C is a grantor of T with respect to the portion of the trust valued at \$900,000. In addition, A or C or both will be treated as the owners of the respective portions of the trust of which each person is a grantor if A or C or both retain powers over or interests in such portions under sections 673 through 677.

*Example 8.* G creates and funds a trust, T1, for the benefit of G's children and grandchildren. After G's death, under authority granted to the trustees in the trust instrument, the trustees of T1 transfer a portion of the assets of T1 to another trust, T2, and retain a power to revoke T2 and revest the assets of T2 in T1. Under paragraphs (e)(1) and (5) of this section, G is the grantor of T1 and T2. In addition, because the trustees of T1 have retained a power to revest the assets of

T2 in T1, T1 is treated as the owner of T2 under section 678(a).

*Example 9.* G creates and funds a trust, T1, for the benefit of B. G retains a power to revest the assets of T1 in G within the meaning of section 676. Under the trust agreement, B is given a general power of appointment over the assets of T1. B exercises the general power of appointment with respect to one-half of the corpus of T1 in favor of a trust, T2, that is for the benefit of C, B's child. Under paragraph (e)(1) of this section, G is the grantor of T1, and under paragraphs (e)(1) and (5) of this section, B is the grantor of T2.

(7) The rules of this section are applicable to any transfer to a trust, or transfer of an interest in a trust, on or after August 10, 1999.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8831, 64 FR 43274, Aug. 10, 1999; T.D. 8890, 65 FR 41333, July 5, 2000]

**§ 1.671-3 Attribution or inclusion of income, deductions, and credits against tax.**

(a) When a grantor or another person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing his tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example:

(1) If a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), he takes into account in computing his income tax liability all items of income, deduction, and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner.

(2) If the portion treated as owned consists of specific trust property and its income, all items directly related to that property are attributable to the portion. Items directly related to trust property not included in the portion treated as owned by the grantor or other person are governed by the provisions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Items that relate both to the portion treated as owned by the grantor and to the balance of the trust must be apportioned in a manner that is reasonable in the light of all the

circumstances of each case, including the terms of the governing instrument, local law, and the practice of the trustee if it is reasonable and consistent.

(3) If the portion of a trust treated as owned by a grantor or another person consists of an undivided fractional interest in the trust, or of an interest represented by a dollar amount, a pro rata share of each item of income, deduction, and credit is normally allocated to the portion. Thus, where the portion owned consists of an interest in or a right to an amount of corpus only, a fraction of each item (including items allocated to corpus, such as capital gains) is attributed to the portion. The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market value of the trust corpus at the beginning of the taxable year in question. The share not treated as owned by the grantor or other person is governed by the provisions of subparts A through D. See the last three sentences of paragraph (c) of this section for the principles applicable if the portion treated as owned consists of an interest in part of the ordinary income in contrast to an interest in corpus alone.

(b) If a grantor or another person is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. For example:

(1) Only ordinary income is included by reason of an interest in or a power over ordinary income alone. Thus, if a grantor is treated under section 673 as an owner by reason of a reversionary interest in ordinary income only, items of income allocable to corpus will not be included in the portion he is treated as owning. Similarly, if a grantor or another person is treated under sections 674-678 as an owner of a portion by reason of a power over ordinary income only, items of income allocable to corpus are not included in that portion. (See paragraph (c) of this section to determine the treatment of deductions and credits when only ordinary income is included in the portion.)

(2) Only income allocable to corpus is included by reason of an interest in or

a power over corpus alone, if satisfaction of the interest or an exercise of the power will not result in an interest in or the exercise of a power over ordinary income which would itself cause that income to be included. For example, if a grantor has a reversionary interest in a trust which is not such as to require that he be treated as an owner under section 673, he may nevertheless be treated as an owner under section 677(a)(2) since any income allocable to corpus is accumulated for future distribution to him, but items of income included in determining ordinary income are not included in the portion he is treated as owning. Similarly, he may have a power over corpus which is such that he is treated as an owner under section 674 or 676 (a), but ordinary income will not be included in the portion he owns, if his power can only affect income received after a period of time such that he would not be treated as an owner of the income if the power were a reversionary interest. (See paragraph (c) of this section to determine the treatment of deductions and credits when only income allocated to corpus is included in the portion.)

(3) Both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or a power over corpus alone which does not come within the provisions of subparagraph (2) of this paragraph. For example, if a grantor is treated under section 673 as the owner of a portion of a trust by reason of a reversionary interest in corpus, both ordinary income and other income allocable to corpus are included in the portion. Further, a grantor includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated under section 674 or 676 as an owner because of a power over corpus which can affect income received within a period such that he would be treated as an owner under section 673 if the power were a reversionary interest. Similarly, a grantor or another person includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated as an owner under section 675 or 678 because of a power over corpus.

(c) If only income allocable to corpus is included in computing a grantor's tax liability, he will take into account in that computation only those items of income, deductions, and credit which would not be included under subparts A through D in the computation of the tax liability of the current income beneficiaries if all distributable net income had actually been distributed to those beneficiaries. On the other hand, if the grantor or another person is treated as an owner solely because of his interest in or power over ordinary income alone, he will take into account in computing his tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to corpus which enter into the computation of distributable net income. If the grantor or other person is treated as an owner because of his power over or right to a dollar amount of ordinary income, he will first take into account a portion of those items of income and expense entering into the computation of ordinary income under the trust instrument or local law sufficient to produce income of the dollar amount required. There will then be attributable to him a pro rata portion of other items entering into the computation of distributable net income under subparts A through D, such as expenses allocable to corpus, and a pro rata portion of credits of the trust. For examples of computations under this paragraph, see paragraph (g) of § 1.677(a)-1.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 6989, 34 FR 742, Jan. 17, 1969]

#### § 1.671-4 Method of reporting.

(a) *Portion of trust treated as owned by the grantor or another person.* Except as otherwise provided in paragraph (b) of this section and § 1.671-5, items of income, deduction, and credit attributable to any portion of a trust that, under the provisions of subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code, is treated as owned by the grantor or another person, are not reported by the trust on Form 1041, "U.S. Income Tax Return for Estates and Trusts," but are shown on a separate statement to be attached to that

form. Section 1.671-5 provides special reporting rules for widely held fixed investment trusts. Section 301.7701-4(e)(2) of this chapter provides guidance regarding the application of the reporting rules in this paragraph (a) to an environmental remediation trust.

(b) *A trust all of which is treated as owned by one or more grantors or other persons*—(1) *In general.* In the case of a trust all of which is treated as owned by one or more grantors or other persons, and which is not described in paragraph (b)(6) or (7) of this section, the trustee may, but is not required to, report by one of the methods described in this paragraph (b) rather than by the method described in paragraph (a) of this section. A trustee may not report, however, pursuant to paragraph (b)(2)(i)(A) of this section unless the grantor or other person treated as the owner of the trust provides to the trustee a complete Form W-9 or acceptable substitute Form W-9 signed under penalties of perjury. See section 3406 and the regulations thereunder for the information to include on, and the manner of executing, the Form W-9, depending upon the type of reportable payments made.

(2) *A trust all of which is treated as owned by one grantor or by one other person*—(i) *In general.* In the case of a trust all of which is treated as owned by one grantor or one other person, the trustee reporting under this paragraph (b) must either—

(A) Furnish the name and taxpayer identification number (TIN) of the grantor or other person treated as the owner of the trust, and the address of the trust, to all payors during the taxable year, and comply with the additional requirements described in paragraph (b)(2)(i) of this section; or

(B) Furnish the name, TIN, and address of the trust to all payors during the taxable year, and comply with the additional requirements described in paragraph (b)(2)(iii) of this section.

(ii) *Additional obligations of the trustee when name and TIN of the grantor or other person treated as the owner of the trust and the address of the trust are furnished to payors.* (A) Unless the grantor or other person treated as the owner of the trust is the trustee or a co-trustee of the trust, the trustee must furnish

the grantor or other person treated as the owner of the trust with a statement that—

(1) Shows all items of income, deduction, and credit of the trust for the taxable year;

(2) Identifies the payor of each item of income;

(3) Provides the grantor or other person treated as the owner of the trust with the information necessary to take the items into account in computing the grantor's or other person's taxable income; and

(4) Informs the grantor or other person treated as the owner of the trust that the items of income, deduction and credit and other information shown on the statement must be included in computing the taxable income and credits of the grantor or other person on the income tax return of the grantor or other person.

(B) The trustee is not required to file any type of return with the Internal Revenue Service.

(iii) *Additional obligations of the trustee when name, TIN, and address of the trust are furnished to payors*—(A) *Obligation to file Forms 1099.* The trustee must file with the Internal Revenue Service the appropriate Forms 1099, reporting the income or gross proceeds paid to the trust during the taxable year, and showing the trust as the payor and the grantor or other person treated as the owner of the trust as the payee. The trustee has the same obligations for filing the appropriate Forms 1099 as would a payor making reportable payments, except that the trustee must report each type of income in the aggregate, and each item of gross proceeds separately. See paragraph (b)(5) of this section regarding the amounts required to be included on any Forms 1099 filed by the trustee.

(B) *Obligation to furnish statement.* (1) Unless the grantor or other person treated as the owner of the trust is the trustee or a co-trustee of the trust, the trustee must also furnish to the grantor or other person treated as the owner of the trust a statement that—

(i) Shows all items of income, deduction, and credit of the trust for the taxable year;

(ii) Provides the grantor or other person treated as the owner of the trust

with the information necessary to take the items into account in computing the grantor's or other person's taxable income; and

(iii) Informs the grantor or other person treated as the owner of the trust that the items of income, deduction and credit and other information shown on the statement must be included in computing the taxable income and credits of the grantor or other person on the income tax return of the grantor or other person.

(2) By furnishing the statement, the trustee satisfies the obligation to furnish statements to recipients with respect to the Forms 1099 filed by the trustee.

(iv) *Examples.* The following examples illustrate the provisions of this paragraph (b)(2):

*Example 1.* G, a United States citizen, creates an irrevocable trust which provides that the ordinary income is to be payable to him for life and that on his death the corpus shall be distributed to B, an unrelated person. Except for the right to receive income, G retains no right or power which would cause him to be treated as an owner under sections 671 through 679. Under the applicable local law, capital gains must be added to corpus. Since G has a right to receive income, he is treated as an owner of a portion of the trust under section 677. The tax consequences of any items of capital gain of the trust are governed by the provisions of subparts A, B, C, and D (section 641 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code. Because not all of the trust is treated as owned by the grantor or another person, the trustee may not report by the methods described in paragraph (b)(2) of this section.

*Example 2.* (i)(A) On January 2, 1996, G, a United States citizen, creates a trust all of which is treated as owned by G. The trustee of the trust is T. During the 1996 taxable year the trust has the following items of income and gross proceeds:

Interest .....	\$2,500
Dividends .....	3,205
Proceeds from sale of B stock .....	2,000

(B) The trust has no items of deduction or credit.

(ii)(A) The payors of the interest paid to the trust are X (\$2,000), Y (\$300), and Z (\$200). The payors of the dividends paid to the trust are A (\$3,200), and D (\$5). The payor of the gross proceeds paid to the trust is D, a brokerage firm, which held the B stock as the nominee for the trust. The B stock was purchased by T for \$1,500 on January 3, 1996, and sold by T on November 29, 1996. T chooses to

report pursuant to paragraph (b)(2)(i)(B) of this section, and therefore furnishes the name, TIN, and address of the trust to X, Y, Z, A, and D. X, Y, and Z each furnish T with a Form 1099-INT showing the trust as the payee. A furnishes T with a Form 1099-DIV showing the trust as the payee. D does not furnish T with a Form 1099-DIV because D paid a dividend of less than \$10 to T. D furnishes T with a Form 1099-B showing the trust as the payee.

(B) On or before February 28, 1997, T files a Form 1099-INT with the Internal Revenue Service on which T reports interest attributable to G, as the owner of the trust, of \$2,500; a Form 1099-DIV on which T reports dividends attributable to G, as the owner of the trust, of \$3,205; and a Form 1099-B on which T reports gross proceeds from the sale of B stock attributable to G, as the owner of the trust, of \$2,000. On or before April 15, 1997, T furnishes a statement to G which lists the following items of income and information necessary for G to take the items into account in computing G's taxable income:

Interest .....	\$2,500
Dividends .....	3,205
Gain from sale of B stock .....	500
Information regarding sale of B stock:	
Proceeds .....	\$2,000
Basis .....	1,500
Date acquired .....	1/03/96
Date sold .....	11/29/96

(C) T informs G that any items of income, deduction and credit and other information shown on the statement must be included in computing the taxable income and credits of the grantor or other person on the income tax return of the grantor or other person.

(D) T has complied with T's obligations under this section.

(iii)(A) Same facts as paragraphs (i) and (ii) of this *Example 2*, except that G contributed the B stock to the trust on January 2, 1996. On or before April 15, 1997, T furnishes a statement to G which lists the following items of income and information necessary for G to take the items into account in computing G's taxable income:

Interest .....	\$2,500
Dividends .....	3,205
Information regarding sale of B stock:	
Proceeds .....	\$2,000
Date sold .....	11/29/96

(B) T informs G that any items of income, deduction and credit and other information shown on the statement must be included in computing the taxable income and credits of the grantor or other person on the income tax return of the grantor or other person.

(C) T has complied with T's obligations under this section.

*Example 3.* On January 2, 1996, G, a United States citizen, creates a trust all of which is treated as owned by G. The trustee of the

trust is T. The only asset of the trust is an interest in C, a common trust fund under section 584(a). T chooses to report pursuant to paragraph (b)(2)(i)(B) of this section and therefore furnishes the name, TIN, and address of the trust to C. C files a Form 1065 and a Schedule K-1 (Partner's Share of Income, Credits, Deductions, etc.) showing the name, TIN, and address of the trust with the Internal Revenue Service and furnishes a copy to T. Because the trust did not receive any amounts described in paragraph (b)(5) of this section, T does not file any type of return with the Internal Revenue Service. On or before April 15, 1997, T furnishes G with a statement that shows all items of income, deduction, and credit of the trust for the 1996 taxable year. In addition, T informs G that any items of income, deduction and credit and other information shown on the statement must be included in computing the taxable income and credits of the grantor or other person on the income tax return of the grantor or other person. T has complied with T's obligations under this section.

(3) *A trust all of which is treated as owned by two or more grantors or other persons*—(i) *In general.* In the case of a trust all of which is treated as owned by two or more grantors or other persons, the trustee must furnish the name, TIN, and address of the trust to all payors for the taxable year, and comply with the additional requirements described in paragraph (b)(3)(ii) of this section.

(ii) *Additional obligations of trustee*—(A) *Obligation to file Forms 1099.* The trustee must file with the Internal Revenue Service the appropriate Forms 1099, reporting the items of income paid to the trust by all payors during the taxable year attributable to the portion of the trust treated as owned by each grantor or other person, and showing the trust as the payor and each grantor or other person treated as an owner of the trust as the payee. The trustee has the same obligations for filing the appropriate Forms 1099 as would a payor making reportable payments, except that the trustee must report each type of income in the aggregate, and each item of gross proceeds separately. See paragraph (b)(5) of this section regarding the amounts required to be included on any Forms 1099 filed by the trustee.

(B) *Obligation to furnish statement.* (1) The trustee must also furnish to each grantor or other person treated as an owner of the trust a statement that—

(i) Shows all items of income, deduction, and credit of the trust for the taxable year attributable to the portion of the trust treated as owned by the grantor or other person;

(ii) Provides the grantor or other person treated as an owner of the trust with the information necessary to take the items into account in computing the grantor's or other person's taxable income; and

(iii) Informs the grantor or other person treated as the owner of the trust that the items of income, deduction and credit and other information shown on the statement must be included in computing the taxable income and credits of the grantor or other person on the income tax return of the grantor or other person.

(2) Except for the requirements pursuant to section 3406 and the regulations thereunder, by furnishing the statement, the trustee satisfies the obligation to furnish statements to recipients with respect to the Forms 1099 filed by the trustee.

(4) *Persons treated as payors*—(i) *In general.* For purposes of this section, the term payor means any person who is required by any provision of the Internal Revenue Code and the regulations thereunder to make any type of information return (including Form 1099 or Schedule K-1) with respect to the trust for the taxable year, including persons who make payments to the trust or who collect (or otherwise act as middlemen with respect to) payments on behalf of the trust.

(ii) *Application to brokers and customers.* For purposes of this section, a broker, within the meaning of section 6045, is considered a payor. A customer, within the meaning of section 6045, is considered a payee.

(5) *Amounts required to be included on Forms 1099 filed by the trustee*—(i) *In general.* The amounts that must be included on any Forms 1099 required to be filed by the trustee pursuant to this section do not include any amounts that are reportable by the payor on an information return other than Form 1099. For example, in the case of a trust which owns an interest in a partnership, the trust's distributive share of the income and gain of the partnership is not includible on any Forms 1099

filed by the trustee pursuant to this section because the distributive share is reportable by the partnership on Schedule K-1.

(ii) *Example.* The following example illustrates the provisions of this paragraph (b)(5):

*Example.* (i)(A) On January 2, 1996, G, a United States citizen, creates a trust all of which is treated as owned by G. The trustee of the trust is T. The assets of the trust during the 1996 taxable year are shares of stock in X, an S corporation, a limited partnership interest in P, shares of stock in M, and shares of stock in N. T chooses to report pursuant to paragraph (b)(2)(i)(B) of this section and therefore furnishes the name, TIN, and address of the trust to X, P, M, and N. M furnishes T with a Form 1099-DIV showing the trust as the payee. N does not furnish T with a Form 1099-DIV because N paid a dividend of less than \$10 to T. X and P furnish T with Schedule K-1 (Shareholder's Share of Income, Credits, Deductions, etc.) and Schedule K-1 (Partner's Share of Income, Credits, Deductions, etc.), respectively, showing the trust's name, TIN, and address.

(B) For the 1996 taxable year the trust has the following items of income and deduction:

Dividends paid by M .....	\$12
Dividends paid by N .....	6
Administrative expense .....	\$20
Items reported by X on Schedule K-1 attributable to trust's shares of stock in X:	
Interest .....	\$20
Dividends .....	35
Items reported by P on Schedule K-1 attributable to trust's limited partnership interest in P:	
Ordinary income .....	\$300

(ii)(A) On or before February 28, 1997, T files with the Internal Revenue Service a Form 1099-DIV on which T reports dividends attributable to G as the owner of the trust in the amount of \$18. T does not file any other returns.

(B) T has complied with T's obligation under paragraph (b)(2)(iii)(A) of this section to file the appropriate Forms 1099.

(6) *Trusts that cannot report under this paragraph (b).* The following trusts cannot use the methods of reporting described in this paragraph (b)—

- (i) A common trust fund as defined in section 584(a);
- (ii) A trust that has its situs or any of its assets located outside the United States;
- (iii) A trust that is a qualified subchapter S trust as defined in section 1361(d)(3);

(iv) A trust all of which is treated as owned by one grantor or one other person whose taxable year is a fiscal year;

(v) A trust all of which is treated as owned by one grantor or one other person who is not a United States person; or

(vi) A trust all of which is treated as owned by two or more grantors or other persons, one of whom is not a United States person.

(7) *Grantors or other persons who are treated as owners of the trust and are exempt recipients for information reporting purposes—*(i) *Trust treated as owned by one grantor or one other person.* The trustee of a trust all of which is treated as owned by one grantor or one other person may not report pursuant to this paragraph (b) if the grantor or other person is an exempt recipient for information reporting purposes.

(ii) *Trust treated as owned by two or more grantors or other persons.* The trustee of a trust, all of which is treated as owned by two or more grantors or other persons, may not report pursuant to this paragraph (b) if one or more grantors or other persons treated as owners are exempt recipients for information reporting purposes unless—

(A) At least one grantor or one other person who is treated as an owner of the trust is a person who is not an exempt recipient for information reporting purposes; and

(B) The trustee reports without regard to whether any of the grantors or other persons treated as owners of the trust are exempt recipients for information reporting purposes.

(8) *Husband and wife who make a single return jointly.* A trust all of which is treated as owned by a husband and wife who make a single return jointly of income taxes for the taxable year under section 6013 is considered to be owned by one grantor for purposes of this paragraph (b).

(c) *Due date for Forms 1099 required to be filed by trustee.* The due date for any Forms 1099 required to be filed with the Internal Revenue Service by a trustee pursuant to this section is the due date otherwise in effect for filing Forms 1099.

(d) *Due date and other requirements with respect to statement required to be furnished by trustee—*(1) *In general.* The

due date for the statement required to be furnished by a trustee to the grantor or other person treated as an owner of the trust pursuant to this section is the date specified by section 6034A(a). The trustee must maintain in its records a copy of the statement furnished to the grantor or other person treated as an owner of the trust for a period of three years from the due date for furnishing such statement specified in this paragraph (d).

(2) *Statement for the taxable year ending with the death of the grantor or other person treated as the owner of the trust.* If a trust ceases to be treated as owned by the grantor, or other person, by reason of the death of that grantor or other person (decedent), the due date for the statement required to be furnished for the taxable year ending with the death of the decedent shall be the date specified by section 6034A(a) as though the decedent had lived throughout the decedent's last taxable year. See paragraph (h) of this section for special reporting rules for a trust or portion of the trust that ceases to be treated as owned by the grantor or other person by reason of the death of the grantor or other person.

(e) *Backup withholding requirements—*(1) *Trustee reporting under paragraph (b)(2)(i)(A) of this section.* In order for the trustee to be able to report pursuant to paragraph (b)(2)(i)(A) of this section and to furnish to all payors the name and TIN of the grantor or other person treated as the owner of the trust, the grantor or other person must provide a complete Form W-9 to the trustee in the manner provided in paragraph (b)(1) of this section, and the trustee must give the name and TIN shown on that Form W-9 to all payors. In addition, if the Form W-9 indicates that the grantor or other person is subject to backup withholding, the trustee must notify all payors of reportable interest and dividend payments of the requirement to backup withhold. If the Form W-9 indicates that the grantor or other person is not subject to backup withholding, the trustee does not have to notify the payors that backup withholding is not required. The trustee should not give the Form W-9, or a copy thereof, to a payor because the Form W-9 contains the address of the

grantor or other person and paragraph (b)(2)(i)(A) of this section requires the trustee to furnish the address of the trust to all payors and not the address of the grantor or other person. The trustee acts as the agent of the grantor or other person for purposes of furnishing to the payors the information required by this paragraph (e)(1). Thus, a payor may rely on the name and TIN provided to the payor by the trustee, and, if given, on the trustee's statement that the grantor is subject to backup withholding.

(2) *Other backup withholding requirements.* Whether a trustee is treated as a payor for purposes of backup withholding is determined pursuant to section 3406 and the regulations thereunder.

(f) *Penalties for failure to file a correct Form 1099 or furnish a correct statement.* A trustee who fails to file a correct Form 1099 or to furnish a correct statement to a grantor or other person treated as an owner of the trust as required by paragraph (b) of this section is subject to the penalties provided by sections 6721 and 6722 and the regulations thereunder.

(g) *Changing reporting methods—*(1) *Changing from reporting by filing Form 1041 to a method described in paragraph (b) of this section.* If the trustee has filed a Form 1041 for any taxable year ending before January 1, 1996 (and has not filed a final Form 1041 pursuant to § 1.671-4(b)(3) (as contained in the 26 CFR part 1 edition revised as of April 1, 1995)), or files a Form 1041 for any taxable year thereafter, the trustee must file a final Form 1041 for the taxable year which ends after January 1, 1995, and which immediately precedes the first taxable year for which the trustee reports pursuant to paragraph (b) of this section, on the front of which form the trustee must write: "Pursuant to § 1.671-4(g), this is the final Form 1041 for this grantor trust."

(2) *Changing from reporting by a method described in paragraph (b) of this section to the filing of a Form 1041.* The trustee of a trust who reported pursuant to paragraph (b) of this section for a taxable year may report pursuant to paragraph (a) of this section for subsequent taxable years. If the trustee reported pursuant to paragraph

(b)(2)(i)(A) of this section, and therefore furnished the name and TIN of the grantor to all payors, the trustee must furnish the name, TIN, and address of the trust to all payors for such subsequent taxable years. If the trustee reported pursuant to paragraph (b)(2)(i)(B) or (b)(3)(i) of this section, and therefore furnished the name and TIN of the trust to all payors, the trustee must indicate on each Form 1096 (Annual Summary and Transmittal of U.S. Information Returns) that it files (or appropriately on magnetic media) for the final taxable year for which the trustee so reports that it is the final return of the trust.

(3) *Changing between methods described in paragraph (b) of this section*—(i) *Changing from furnishing the TIN of the grantor to furnishing the TIN of the trust.* The trustee of a trust who reported pursuant to paragraph (b)(2)(i)(A) of this section for a taxable year, and therefore furnished the name and TIN of the grantor to all payors, may report pursuant to paragraph (b)(2)(i)(B) of this section, and furnish the name and TIN of the trust to all payors, for subsequent taxable years.

(ii) *Changing from furnishing the TIN of the trust to furnishing the TIN of the grantor.* The trustee of a trust who reported pursuant to paragraph (b)(2)(i)(B) of this section for a taxable year, and therefore furnished the name and TIN of the trust to all payors, may report pursuant to paragraph (b)(2)(i)(A) of this section, and furnish the name and TIN of the grantor to all payors, for subsequent taxable years. The trustee, however, must indicate on each Form 1096 (Annual Summary and Transmittal of U.S. Information Returns) that it files (or appropriately on magnetic media) for the final taxable year for which the trustee reports pursuant to paragraph (b)(2)(i)(B) of this section that it is the final return of the trust.

(4) *Example.* The following example illustrates the provisions of paragraph (g) of this section:

*Example.* (i) On January 3, 1994, G, a United States citizen, creates a trust all of which is treated as owned by G. The trustee of the trust is T. On or before April 17, 1995, T files with the Internal Revenue Service a Form 1041 with an attached statement for the 1994

taxable year showing the items of income, deduction, and credit of the trust. On or before April 15, 1996, T files with the Internal Revenue Service a Form 1041 with an attached statement for the 1995 taxable year showing the items of income, deduction, and credit of the trust. On the Form 1041, T states that “pursuant to § 1.671-4(g), this is the final Form 1041 for this grantor trust.” T may report pursuant to paragraph (b) of this section for the 1996 taxable year.

(ii) T reports pursuant to paragraph (b)(2)(i)(B) of this section, and therefore furnishes the name, TIN, and address of the trust to all payors, for the 1996 and 1997 taxable years. T chooses to report pursuant to paragraph (a) of this section for the 1998 taxable year. On each Form 1096 (Annual Summary and Transmittal of U.S. Information Returns) which T files for the 1997 taxable year (or appropriately on magnetic media), T indicates that it is the trust’s final return. On or before April 15, 1999, T files with the Internal Revenue Service a Form 1041 with an attached statement showing the items of income, deduction, and credit of the trust. On the Form 1041, T uses the same TIN which T used on the Forms 1041 and Forms 1099 it filed for previous taxable years. T has complied with T’s obligations under paragraph (g)(2) of this section.

(h) *Reporting rules for a trust, or portion of a trust, that ceases to be treated as owned by a grantor or other person by reason of the death of the grantor or other person*—(1) *Definition of decedent.* For purposes of this paragraph (h), the *decedent* is the grantor or other person treated as the owner of the trust, or portion of the trust, under subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code on the date of death of that person.

(2) *In general.* The provisions of this section apply to a trust, or portion of a trust, treated as owned by a decedent for the taxable year that ends with the decedent’s death. Following the death of the decedent, the trust or portion of a trust that ceases to be treated as owned by the decedent, by reason of the death of the decedent, may no longer report under this section. A trust, all of which was treated as owned by the decedent, must obtain a new TIN upon the death of the decedent, if the trust will continue after the death of the decedent. See § 301.6109-1(a)(3)(i) of this chapter for rules regarding obtaining a TIN upon the death of the decedent.

(3) *Special rules*—(i) *Trusts reporting pursuant to paragraph (a) of this section for the taxable year ending with the decedent's death.* The due date for the filing of a return pursuant to paragraph (a) of this section for the taxable year ending with the decedent's death shall be the due date provided for under §1.6072-1(a)(2). The return filed under this paragraph for a trust all of which was treated as owned by the decedent must indicate that it is a final return.

(ii) *Trust reporting pursuant to paragraph (b)(2)(B) of this section for the taxable year of the decedent's death.* A trust that reports pursuant to paragraph (b)(2)(B) of this section for the taxable year ending with the decedent's death must indicate on each Form 1096 "Annual Summary and Transmittal of the U.S. Information Returns" that it files (or appropriately on magnetic media) for the taxable year ending with the death of the decedent that it is the final return of the trust.

(iii) *Trust reporting under paragraph (b)(3) of this section.* If a trust has been reporting under paragraph (b)(3) of this section, the trustee may not report under that paragraph if any portion of the trust has a short taxable year by reason of the death of the decedent and the portion treated as owned by the decedent does not terminate on the death of the decedent.

(i) *Effective date and transition rule*—(1) *Effective date.* The trustee of a trust any portion of which is treated as owned by one or more grantors or other persons must report pursuant to paragraphs (a), (b), (c), (d)(1), (e), (f), and (g) of this section for taxable years beginning on or after January 1, 1996.

(2) *Transition rule.* For taxable years beginning prior to January 1, 1996, the Internal Revenue Service will not challenge the manner of reporting of—

(i) A trustee of a trust all of which is treated as owned by one or more grantors or other persons who did not report in accordance with §1.671-4(a) (as contained in the 26 CFR part 1 edition revised as of April 1, 1995) as in effect for taxable years beginning prior to January 1, 1996, but did report in a manner substantially similar to one of the reporting methods described in paragraph (b) of this section; or

(ii) A trustee of two or more trusts all of which are treated as owned by one or more grantors or other persons who filed a single Form 1041 for all of the trusts, rather than a separate Form 1041 for each trust, provided that the items of income, deduction, and credit of each trust were shown on a statement attached to the single Form 1041.

(3) *Effective date for paragraphs (d)(2) and (h) of this section.* Paragraphs (d)(2) and (h) of this section apply for taxable years ending on or after December 24, 2002.

(j) *Cross-reference.* For rules relating to employer identification numbers, and to the obligation of a payor of income or proceeds to the trust to furnish to the payee a statement to recipient, see §301.6109-1(a)(2) of this chapter.

[T.D. 8633, 60 FR 66087, Dec. 21, 1995, as amended by T.D. 8668, 61 FR 19191, May 1, 1996; T.D. 9032, 67 FR 78381, Dec. 24, 2002; T.D. 9241, 71 FR 4009, Jan. 24, 2006]

#### §1.671-5 Reporting for widely held fixed investment trusts.

(a) *Table of contents.* This table of contents lists the major paragraph headings for this section.

- (a) Table of contents.
- (b) Definitions.
- (c) Trustee's obligation to report information.
  - (1) In general.
  - (i) Calculation.
  - (ii) Calculation period.
  - (iii) Accounting method.
  - (iv) Gross income requirement.
  - (2) Information to be reported by all WHFITs.
    - (i) Trust identification and calculation period chosen.
    - (ii) Items of income, expense, and credit.
    - (iii) Non pro-rata partial principal payments.
    - (iv) Asset sales and dispositions.
    - (v) Redemptions and sales of WHFIT interests.
    - (vi) Information regarding bond premium.
    - (vii) Information regarding market discount.
    - (viii) Other information.
  - (3) Identifying the representative who will provide trust information.
  - (4) Time and manner of providing information.
    - (i) Time.
    - (ii) Manner.
    - (iii) Inclusion of information with respect to all calculation periods.
  - (5) Requesting information from a WHFIT.
    - (i) In general.
    - (ii) Manner of requesting information.



(k) Coordination with other information reporting rules.

(l) Backup withholding requirements.

(m) Penalties for failure to comply.

(n) Effective date.

(b) *Definitions.* Solely for purposes of this section:

(1) An *asset* includes any real or personal, tangible or intangible property held by the trust, including an interest in a contract.

(2) An *affected expense* is an expense described in § 1.67-2T(i)(1).

(3) A *beneficial owner* is a trust interest holder (TIH) (as defined in paragraph (b)(20) of this section) that holds a beneficial interest in a widely held fixed investment trust (WHFIT) (as defined in paragraph (b)(22) of this section.)

(4) The *calculation period* is the period the trustee chooses under paragraph (c)(1)(ii) of this section for calculating the trust information required to be provided under paragraph (c) of this section.

(5) The *cash held for distribution* is the amount of cash held by the WHFIT (other than trust sales proceeds and proceeds from sales described in paragraphs (c)(2)(iv)(D)(4), (G), and (H) of this section) less reasonably required reserve funds as of the date that the amount of a distribution is required to be determined under the WHFIT's governing document.

(6) A *clean-up call* is the redemption of all trust interests in termination of the WHFIT when the administrative costs of the WHFIT outweigh the benefits of maintaining the WHFIT.

(7) An *exempt recipient* is—

(i) Any person described in § 1.6049-4(c)(1)(ii);

(ii) A middleman (as defined in paragraph (b)(10) of this section);

(iii) A real estate mortgage investment conduit (as defined in section 860(D)(a)) (REMIC);

(iv) A WHFIT; or

(v) A trust or an estate for which the trustee or middleman of the WHFIT is also required to file a Form 1041, "U.S. Income Tax Return for Estates and Trusts," in its capacity as a fiduciary of that trust or estate.

(8) An *in-kind redemption* is a redemption in which a beneficial owner receives a pro-rata share of each of the

assets of the WHFIT that the beneficial owner is deemed to own under section 671. For example, for purposes of this paragraph (b)(8), if beneficial owner A owns a one percent interest in a WHFIT that holds 100 shares of X corporation stock, so that A is considered to own a one percent interest in each of the 100 shares, A's pro-rata share of the X corporation stock for this purpose is one share of X corporation stock.

(9) An *item* refers to an item of income, expense, or credit as well as any trust event (for example, the sale of an asset) or any characteristic or attribute of the trust that affects the income, deductions, and credits reported by a beneficial owner in any taxable year that the beneficial owner holds an interest in the trust. An item may refer to an individual item or a group of items depending on whether the item must be reported separately under paragraphs (c)(1)(i) and (e)(1) of this section.

(10) A *middleman* is any TIH, other than a qualified intermediary as defined in § 1.1031(k)-1(g), who, at any time during the calendar year, holds an interest in a WHFIT on behalf of, or for the account of, another TIH, or who otherwise acts in a capacity as an intermediary for the account of another person. A middleman includes, but is not limited to—

(i) A custodian of a person's account, such as a bank, financial institution, or brokerage firm acting as custodian of an account;

(ii) A nominee;

(iii) A joint owner of an account or instrument other than—

(A) A joint owner who is the spouse of the other owner; and

(B) A joint owner who is the beneficial owner and whose name appears on the Form 1099 filed with respect to the trust interest under paragraph (d) of this section; and

(iv) A broker (as defined in section 6045(c)(1) and § 1.6045-1(a)(1)), holding an interest for a customer in street name.

(11) A *mortgage* is an obligation that is principally secured by an interest in real property within the meaning of § 1.860G-2(a)(5), except that a mortgage does not include an interest in another WHFIT or mortgages held by another WHFIT.

(12) A *non-mortgage widely held fixed investment trust* (NMWHFIT) is a WHFIT other than a widely held mortgage trust (as defined in paragraph (b)(23) of this section).

(13) A *non pro-rata partial principal payment* is any partial payment of principal received on a debt instrument which does not retire the debt instrument and which is not a pro-rata prepayment described in § 1.1275-2(f)(2).

(14) The *redemption asset proceeds* equal the redemption proceeds (as defined in paragraph (b)(15) of this section) less the cash held for distribution with respect to the redeemed trust interest.

(15) The *redemption proceeds* equal the total amount paid to a redeeming TIH as the result of a redemption of a trust interest.

(16) A *requesting person* is—

- (i) A middleman;
- (ii) A beneficial owner who is a broker;
- (iii) A beneficial owner who is an exempt recipient who holds a trust interest directly and not through a middleman;
- (iv) A noncalendar-year beneficial owner who holds a trust interest directly and not through a middleman; or

(v) A representative or agent of a person specified in this paragraph (b)(16).

(17) The *sales asset proceeds* equal the sales proceeds (as defined in paragraph (b)(18) of this section) less the cash held for distribution with respect to the sold trust interest at the time of the sale.

(18) The *sales proceeds* equal the total amount paid to a selling TIH in consideration for the sale of a trust interest.

(19) The *start-up date* is the date on which substantially all of the assets have been deposited with the trustee of the WHFIT.

(20) A *trust interest holder* (TIH) is any person who holds a direct or indirect interest, including a beneficial interest, in a WHFIT at any time during the calendar year.

(21) *Trust sales proceeds* equal the amount paid to a WHFIT for the sale or disposition of an asset held by the WHFIT, including principal payments received by the WHFIT that completely retire a debt instrument (other

than a final scheduled principal payment) and pro-rata partial principal prepayments described under § 1.1275-2(f)(2). Trust sales proceeds do not include amounts paid for any interest income that would be required to be reported under § 1.6045-1(d)(3). Trust sales proceeds also do not include amounts paid to a NMWHFIT as the result of pro-rata sales of trust assets to effect a redemption described in paragraph (c)(2)(iv)(G) of this section or the value of assets received as a result of a tax-free corporate reorganization as described in paragraph (c)(2)(iv)(H) of this section.

(22) A *widely held fixed investment trust* (WHFIT) is an arrangement classified as a trust under § 301.7701-4(c) of this chapter, provided that—

- (i) The trust is a United States person under section 7701(a)(30)(E);
- (ii) The beneficial owners of the trust are treated as owners under subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code; and
- (iii) At least one interest in the trust is held by a middleman.

(23) A *widely held mortgage trust* (WHMT) is a WHFIT, the assets of which consist only of one or more of the following—

- (i) Mortgages;
- (ii) Regular interests in a REMIC;
- (iii) Interests in another WHMT;
- (iv) Reasonably required reserve funds;

(v) Amounts received on the assets described in paragraphs (b)(23)(i), (ii), (iii), and (iv) of this section pending distribution to TIHs; and

(vi) During a brief initial funding period, cash and short-term contracts for the purchase of the assets described in paragraphs (b)(23)(i), (ii), and (iii).

(c) *Trustee's obligation to report information*—(1) *In general*. Upon the request of a requesting person (as defined in paragraph (b)(16) of this section), a trustee of a WHFIT must report the information described in paragraph (c)(2) of this section to the requesting person. The trustee must determine such information in accordance with the following rules—

- (i) *Calculation*. WHFIT information may be calculated in any manner that enables a requesting person to determine with reasonable accuracy the

WHFIT items described in paragraph (c)(2) of this section that are attributable (or, if permitted under paragraphs (c)(2)(iv)(B) or (f)(2)(iii) of this section, distributed) to a beneficial owner for the taxable year of that owner. The manner of calculation must generally conform with industry practice for calculating the WHFIT items described in paragraph (c)(2) of this section for the type of asset or assets held by the WHFIT, and must enable a requesting person to separately state any WHFIT item that, if taken into account separately by a beneficial owner, would result in an income tax liability different from that which would result if the owner did not take the item into account separately.

(ii) *Calculation period*—WHFIT information may be calculated on the basis of a calendar month, calendar quarter, or half or full calendar year, provided that a trustee uses the same calculation period for the life of the WHFIT and the information provided by the trustee meets the requirements of paragraph (c)(1)(i) of this section. Regardless of the calculation period chosen by the trustee, the trustee must provide information requested by a requesting person under paragraph (c)(5) on a calendar year basis. The trustee may provide additional information to requesting persons throughout the calendar year at the trustee's discretion.

(iii) *Accounting method*—(A) *General rule.* WHFIT information must be calculated and reported using the cash receipts and disbursements method of accounting unless another method is required by the Internal Revenue Code or regulations with respect to a specific trust item. Accordingly, a trustee must provide information necessary for TIHs to comply with the rules of subtitle A, chapter 1, subchapter P, part V, subpart A of the Internal Revenue Code, which require the inclusion of accrued amounts with respect to OID, and section 860B(b), which requires the inclusion of accrued amounts with respect to a REMIC regular interest.

(B) *Exception for WHFITs marketed predominantly to taxpayers on the accrual method.* If the trustee or the trust's sponsor knows or reasonably should know that a WHFIT is marketed primarily to accrual method

TIHs and the WHFIT holds assets for which the timing of the recognition of income is materially affected by the use of the accrual method of accounting, the trustee must calculate and report trust information using the accrual method of accounting.

(iv) *Gross income requirement.* The amount of income required to be reported by the trustee is the gross income (as defined in section 61) generated by the WHFIT's assets. Thus, in the case of a WHFIT that receives a payment of income from which an expense (or expenses) has been deducted, the trustee, in calculating the income to be reported under paragraph (c)(2)(ii) of this section, must report the income earned on the trusts assets unreduced by the deducted expense or expenses and separately report the deducted expense or expenses. See paragraph (c)(2)(iv) of this section regarding reporting with respect to sales and dispositions.

(2) *Information to be reported by all WHFITs.* With respect to all WHFITs—

(i) *Trust identification and calculation period chosen.* The trustee must report information identifying the WHFIT, including—

- (A) The name of the WHFIT;
- (B) The employer identification number of the WHFIT;
- (C) The name and address of the trustee;
- (D) The Committee on Uniform Security Identification Procedure (CUSIP) number, account number, serial number, or other identifying number of the WHFIT;
- (E) The classification of the WHFIT as either a WHMT or NMWHFIT; and
- (F) The calculation period used by the trustee.

(ii) *Items of income, expense, and credit.* The trustee must report information detailing—

(A) All items of gross income (including OID, except that OID is not required to be included for a WHMT that has a start-up date (as defined in paragraph (b)(19) of this section) prior to August 13, 1998).

(B) All items of expense (including affected expenses); and

(C) All items of credit.

(iii) *Non pro-rata partial principal payments.* The trustee must report information detailing non pro-rata partial principal payments (as defined in paragraph (b)(13) of this section) received by the WHFIT.

(iv) *Asset sales and dispositions.* The trustee must report information regarding sales and dispositions of WHFIT assets as required in this paragraph (c)(2)(iv). For purposes of this paragraph (c)(2)(iv), a payment (other than a final scheduled payment) that completely retires a debt instrument (including a mortgage held by a WHMT) or a pro-rata prepayment on a debt instrument (see § 1.1275-2(f)(2)) held by a WHFIT must be reported as a full or partial sale or disposition of the debt instrument. Pro-rata sales of trust assets to effect redemptions, as defined in paragraph (c)(2)(iv)(G) of this section, or exchanges of trust assets as the result of a corporate reorganization under paragraph (c)(2)(iv)(H) of this section, are not reported as sales or dispositions under this paragraph (c)(2)(iv).

(A) *General rule.* Except as provided in paragraph (c)(2)(iv)(B) (regarding the exception for certain NMWHFITs) or paragraph (c)(2)(iv)(C) (regarding the exception for certain WHMTs) of this section, the trustee must report with respect to each sale or disposition of a WHFIT asset—

(1) The date of each sale or disposition;

(2) Information that enables a requesting person to determine the amount of trust sales proceeds (as defined in paragraph (b)(21) of this section) attributable to a beneficial owner as a result of each sale or disposition; and

(3) Information that enables a beneficial owner to allocate, with reasonable accuracy, a portion of the owner's basis in its trust interest to each sale or disposition.

(B) *Exception for certain NMWHFITs.* If a NMWHFIT meets paragraph (c)(2)(iv)(D)(1) (regarding the general de minimis test), paragraph (c)(2)(iv)(E) (regarding the qualified NMWHFIT exception), or paragraph (c)(2)(iv)(F) (regarding the NMWHFIT final calendar year exception) of this section, the trustee is not required to report under

paragraph (c)(2)(iv)(A) of this section. Instead, the trustee must report sufficient information to enable a requesting person to determine the amount of trust sales proceeds distributed to a beneficial owner during the calendar year with respect to each sale or disposition of a trust asset. The trustee also must provide requesting persons with a statement that the NMWHFIT is permitted to report under this paragraph (c)(2)(iv)(B).

(C) *Exception for certain WHMTs.* If a WHMT meets either the general or the special de minimis test of paragraph (c)(2)(iv)(D) of this section for the calendar year, the trustee is not required to report under paragraph (c)(2)(iv)(A) of this section. Instead, the trustee must report information to enable a requesting person to determine the amount of trust sales proceeds attributable to a beneficial owner as a result of the sale or disposition. The trustee also must provide requesting persons with a statement that the WHMT is permitted to report under this paragraph (c)(2)(iv)(C).

(D) *De minimis tests—(1) General WHFIT de minimis test.* The general WHFIT de minimis test is satisfied if trust sales proceeds for the calendar year are not more than five percent of the net asset value of the trust (aggregate fair market value of the trust's assets less the trust's liabilities) as of the later of January 1 and the start-up date (as defined paragraph (b)(19) of this section); or, if the trustee chooses, the later of January 1 and the measuring date. The measuring date is the date of the last deposit of assets into the WHFIT (not including any deposit of assets into the WHFIT pursuant to a distribution reinvestment program), not to exceed 90 days after the date the registration statement of the WHFIT becomes effective under the Securities Act of 1933.

(2) *Special WHMT de minimis test.* A WHMT that meets the asset requirement of paragraph (g)(1)(ii)(E) of this section satisfies the special WHMT de minimis test in this paragraph (c)(2)(iv)(D)(2) if trust sales proceeds for the calendar year are not more than five percent of the aggregate outstanding principal balance of the WHMT (as defined in paragraph

(g)(1)(iii)(D) of this section) as of the later of January 1 of that year or the trust's start-up date. For purposes of applying the special WHMT de minimis test in this paragraph (c)(2)(iv)(D)(2), amounts that result from the complete or partial payment of the outstanding principal balance of the mortgages held by the trust are not included in the amount of trust sales proceeds. The IRS and the Treasury Department may provide by revenue ruling, or by other published guidance, that the special de minimis test of this paragraph (c)(2)(iv)(D)(2) may be applied to WHFITs holding debt instruments other than those described in paragraph (g)(1)(ii)(E) of this section.

(3) *Effect of clean-up call.* If a WHFIT fails to meet either de minimis test described in this paragraph (c)(2)(iv)(D) solely as the result of a clean-up call, as defined in paragraph (b)(6) of this section, the WHFIT will be treated as having met the de minimis test.

(4) *Exception for certain fully reported sales—(i) Rule.* If a trustee of a NMWHFIT reports the sales described in paragraph (c)(2)(iv)(D)(4)(ii) of this section as provided under paragraph (c)(2)(iv)(A) of this section (regardless of whether the general minimis test in paragraph (c)(2)(iv)(D)(1) of this section is satisfied for a particular calendar year) consistently throughout the life of the WHFIT, a trustee may exclude the trust sales proceeds received by the WHFIT as a result of those sales from the trust sales proceeds used to determine whether a WHFIT has satisfied the general de minimis test in paragraph (c)(2)(iv)(D)(1) of this section.

(ii) *Applicable sales and dispositions.* This paragraph (c)(2)(iv)(D)(4) applies to sales and dispositions resulting from corporate reorganizations and restructurings for which the trust receives cash, the sale of assets received by the trust in corporate reorganizations and restructurings (including conversions of closed-end investment companies to open-end investment companies), principal prepayments, bond calls, bond maturities, and the sale of securities by the trustee as required by the governing document or applicable law governing fiduciaries in order to maintain the sound investment character of the trust, and any

other nonvolitional dispositions of trust assets.

(iii) *Certain small sales and dispositions.* If the amount of trust sales proceeds from a sale or disposition described in paragraph (c)(2)(iv)(D)(4)(ii) of this section is less than .01 percent of the net fair market value of the WHFIT as determined for applying the de minimis test for the calendar year, the trustee is not required to report the sale or disposition under paragraph (c)(2)(iv)(A) of this section provided the trustee includes the trust sales proceeds, received for purposes of determining whether the trust has met the general de minimis test of paragraph (c)(2)(iv)(D)(1) of this section.

(E) *Qualified NMWHFIT exception.* The qualified NMWHFIT exception is satisfied if—

(1) The NMWHFIT has a start-up date (as defined in paragraph (b)(19) of this section) before February 23, 2006;

(2) The registration statement of the NMWHFIT becomes effective under the Securities Act of 1933, as amended (15 U.S.C. 77a, *et seq.*) and trust interests are offered for sale to the public before February 23, 2006; or

(3) The registration statement of the NMWHFIT becomes effective under the Securities Act of 1933 and trust interests are offered for sale to the public on or after February 23, 2006, and before July 31, 2006, and the NMWHFIT is fully funded before October 1, 2006. For purposes of determining whether a NMWHFIT is fully funded under this paragraph (c)(2)(iv)(E), deposits to the NMWHFIT after October 1, 2006, that are made pursuant to a distribution reinvestment program that is consistent with the requirements of §301.7701-4(c) of this chapter are disregarded.

(F) *NMWHFIT final calendar year exception.* The NMWHFIT final calendar year exception is satisfied if—

(1) The NMWHFIT terminates on or before December 31 of the year for which the trustee is reporting;

(2) Beneficial owners exchange their interests for cash or are treated as having exchanged their interests for cash upon termination of the trust; and

(3) The trustee makes reasonable efforts to engage in pro-rata sales of trust assets to effect redemptions.

§ 1.671-5

26 CFR Ch. I (4-1-12 Edition)

(G) *Pro-rata sales of trust assets to effect a redemption*—(1) *Rule.* Pro-rata sales of trust assets to effect redemptions are not required to be reported under this paragraph (c)(2)(iv).

(2) *Definition.* Pro-rata sales of trust assets to effect redemptions occur when—

(i) One or more trust interests are tendered for redemption;

(ii) The trustee identifies the pro-rata shares of the trust assets that are deemed to be owned by the trust interest or interests tendered for redemption (See paragraph (b)(8) of this section for a description of how pro-rata is to be applied for purposes of this paragraph (c)(2)(iv)(G)) and sells those assets as soon as practicable;

(iii) Proceeds from the sales of the assets identified in paragraph (c)(2)(iv)(G)(2)(ii) of this section are used solely to effect redemptions; and

(iv) The redemptions are reported as required under paragraph (c)(2)(v) of this section by the trustee.

(3) *Additional rules*—(i) *Calendar month aggregation.* The trustee may compare the aggregate pro-rata share of the assets deemed to be owned by the trust interests tendered for redemption during the calendar month with the aggregate sales of assets to effect redemptions for the calendar month to determine the pro-rata sales of trust assets to effect redemptions for the calendar month. If the aggregate pro-rata share of an asset deemed to be owned by the trust interests tendered for redemption for the month is a fractional amount, the trustee may round that number up to the next whole number for the purpose of determining the pro-rata sales to effect redemptions for the calendar month;

(ii) *Sales of assets to effect redemptions may be combined with sales of assets for other purposes.* Sales of assets to effect redemptions may be combined with the sales of assets to obtain cash for other purposes but the proceeds from the sales of assets to effect redemptions must be used solely to provide cash for redemptions and the sales of assets to obtain cash for other purposes must be reported as otherwise provided in this paragraph (c)(2)(iv). For example, if a trustee sells assets and the proceeds are used by the trustee to pay trust ex-

penses, these amounts are to be included in the amounts reported under paragraph (c)(2)(iv)(A) or (B), as appropriate.

(4) *Example*—(i) *January 1, 2008.* Trust has one million trust interests and all interests have equal value and equal rights. The number of shares of stock in corporations A through J and the pro-rata share of each stock that a trust interest is deemed to own as of January 1, 2008, is as follows:

Stock	Total shares	Per trust interest
A .....	24,845	.024845
B .....	28,273	.028273
C .....	35,575	.035575
D .....	13,866	.013866
E .....	25,082	.025082
F .....	39,154	.039154
G .....	16,137	.016137
H .....	14,704	.014704
I .....	17,436	.017436
J .....	31,133	.031133

(ii) *Transactions of January 2, 2008.* On January 2, 2008, 50,000 trust interests are tendered for redemption. The deemed pro-rata ownership of stocks A through J represented by the 50,000 redeemed trust interests and the stocks sold to provide cash for the redemptions are set out in the following table:

Stock	Deemed pro-rata ownership	Shares sold
A .....	1,242.25	1,242
B .....	1,413.65	1,413
C .....	1,778.75	1,779
D .....	693.30	694
E .....	1,254.10	1,254
F .....	1,957.70	1,957
G .....	806.85	807
H .....	735.20	735
I .....	871.80	872
J .....	1,556.65	1,557

(iii) *Transactions on January 15 through 17, 2008.* On January 15, 2008, 10,000 trust interests are tendered for redemption. Trustee lends money to Trust for redemptions. On January 16, B merges into C at a rate of .55 per share. On January 17, Trustee sells stock to obtain cash to be reimbursed the cash loaned to Trust to effect the redemptions. The pro-rata share of the stock deemed to be owned by the 10,000 redeemed trust interests and the stock sold by the trustee to effect the redemptions are set out in the following table:

Stock	Deemed pro-rata ownership	Shares sold
A .....	248.45	249
B .....	00	00
C .....	511.25	512
D .....	138.66	138

Internal Revenue Service, Treasury

§ 1.671-5

Stock	Deemed pro-rata ownership	Shares sold
E .....	250.82	251
F .....	391.54	392
G .....	161.37	162
H .....	147.04	148
I .....	174.36	174
J .....	311.33	311

(iv) *Transactions on January 28 and 29, 2008.* On January 28, 2008, the value of the H stock is \$30.00 per share and Trustee, pursuant to Trust's governing document, sells the H stock to preserve the financial integrity of Trust and receives \$414,630. Trustee intends to report this sale under paragraph (c)(2)(iv)(A) of this section and to distribute the proceeds of the sale pro-rata to trust interest holders on Trust's next scheduled distribution date. On January 29, 2008, while trustee still holds the proceeds from the January 28 sale, 10,000 trust interests are tendered for redemption. The pro-rata share of the stock deemed to be owned by the 10,000 redeemed trust interests and the stock sold by the trustee to effect the redemptions are set out in the following table:

Stock	Deemed pro-rata ownership	Shares sold
A .....	248.45	248
B .....	0	0
C .....	511.25	511
D .....	138.66	139
E .....	250.82	251
F .....	391.54	391
G .....	161.37	161
H .....	10	0
I .....	174.36	175
J .....	311.33	312

<sup>1</sup>Share of cash proceeds: \$4,458.39.

(v) *Monthly amounts.* To determine the pro-rata sales to effect redemptions for January, trustee compares the aggregate pro-rata share of stocks A through J (rounded to the next whole number) deemed to be owned by the trust interests tendered for redemption during the month of January with the sales of stocks A through J to effect redemptions:

Stock	Deemed pro-rata ownership	Shares sold
A .....	1740	1739
B .....	0	0
C .....	3579	3579
D .....	971	971
E .....	1756	1756
F .....	2741	2741
G .....	1130	1130
H .....	883	883
I .....	1221	1221
J .....	2180	2180

(vi) *Pro-rata sales to effect redemptions for the month of January.* For the month of January, the deemed pro-rata ownership of shares

of stocks A through J equal or exceed the sales of stock to effect redemptions for the month. Accordingly, all of the sales to effect redemptions during the month of January are considered to be pro-rata and are not required to be reported under this paragraph (c)(2)(iv).

(H) *Corporate Reorganizations.* The exchange of trust assets for other assets of equivalent value pursuant to a tax free corporate reorganization is not required to be reported as a sale or disposition under this paragraph (c)(2)(iv).

(v) *Redemptions and sales of WHFIT interests—(A) Redemptions—(1) In general.* Unless paragraph (c)(2)(v)(C) of this section applies, for each date on which the amount of a redemption proceeds for the redemption of a trust interest is determined, the trustee must provide information to enable a requesting person to determine—

(i) The redemption proceeds (as defined in paragraph (b)(15) of this section) per trust interest on that date;

(ii) The redemption asset proceeds (as defined in paragraph (b)(14) of this section) per trust interest on that date; and

(iii) The gross income that is attributable to the redeeming beneficial owner for the portion of the calendar year that the redeeming beneficial owner held its interest (including income earned by the WHFIT after the date of the last income distribution).

(2) *In kind redemptions.* The value of the assets received with respect to an in-kind redemption (as defined in paragraph (b)(8) of this section) is not required to be reported under this paragraph (c)(2)(v)(A). Information regarding the income attributable to a redeeming beneficial owner must, however, be reported under paragraph (c)(2)(v)(A)(i)(iii) of this section.

(B) *Sale of a trust interest.* Under paragraph (c)(2)(v)(C) of this section applies, if a secondary market for interests in the WHFIT is established, the trustee must provide, for each day of the calendar year, information to enable requesting persons to determine—

(1) The sale assets proceeds (as defined in paragraph (b)(17) of this section) per trust interest on that date; and

(2) The gross income that is attributable to a selling beneficial owner and to a purchasing beneficial owner for

the portion of the calendar year that each held the trust interest.

(C) *Simplified Reporting for Certain NMWHFITs—(1) In general.* The trustee of an NMWHFIT described in paragraph (c)(2)(v)(C)(2) of this section is not required to report the information described in paragraph (c)(2)(v)(A) of this section (regarding redemptions) or (c)(2)(v)(B) of this section (regarding sales). However, the trustee must report to requesting persons, for each date on which the amount of redemption proceeds to be paid for the redemption of a trust interest is determined, information that will enable requesting persons to determine the redemption proceeds per trust interest on that date. The trustee also must provide requesting persons with a statement that this paragraph applies to the NMWHFIT.

(2) *NMWHFITs that qualify for the exception.* This paragraph (c)(2)(v)(C) applies to a NMWHFIT if—

(i) Substantially all the assets of the NMWHFIT produce income that is treated as interest income (but only if these assets trade on a recognized exchange or securities market without a price component attributable to accrued interest) or produce dividend income (as defined in section 6042(b) and the regulations under that section). (Trust sales proceeds and gross proceeds from sales described in paragraphs (c)(2)(iv)(G) and (H) of this section are ignored for the purpose of determining if substantially all of a NMWHFIT's assets produce dividend or the interest income described in this paragraph); and

(ii) The qualified NMWHFIT exception of paragraph (c)(2)(iv)(E) of this section is satisfied, or the trustee is required by the governing document of the NMWHFIT to determine and distribute all cash held for distribution (as defined in paragraph (b)(5) of this section) no less frequently than monthly. A NMWHFIT will be considered to have satisfied this paragraph (c)(2)(v)(C)(2)(i) notwithstanding that the governing document of the NMWHFIT permits the trustee to forego making a required monthly or more frequent distribution, if the cash held for distribution is less than 0.1 percent of the aggregate net asset value of the

trust as of the date specified in the governing document for calculating the amount of the monthly distribution.

(vi) *Information regarding bond premium.* The trustee generally must report information that enables a beneficial owner to determine, in any manner that is reasonably consistent with section 171, the amount of the beneficial owner's amortizable bond premium, if any, for each calendar year. However, if a NMWHFIT meets the general *de minimis* test in paragraph (c)(2)(iv)(D)(1) of this section, the qualified NMWHFIT exception of paragraph (c)(2)(iv)(E) of this section, or the NMWHFIT final calendar year exception of paragraph (c)(2)(iv)(F) of this section, the trustee of the NMWHFIT is not required to report information regarding bond premium.

(vii) *Information regarding market discount.* The trustee generally must report information that enables a beneficial owner to determine, in any manner reasonably consistent with section 1276 (including section 1276(a)(3)), the amount of market discount that has accrued during the calendar year. However, if a NMWHFIT meets the general *de minimis* test in paragraph (c)(2)(iv)(D) of this section, the qualified NMWHFIT exception of paragraph (c)(2)(iv)(E) of this section, or the NMWHFIT final calendar year exception of paragraph (c)(2)(iv)(F) of this section, the trustee of such NMWHFIT is not required to provide information regarding market discount.

(viii) *Other information.* The trustee must provide any other information necessary for a beneficial owner of a trust interest to report, with reasonable accuracy, the items (as defined in paragraph (b)(9) of this section) attributable to the portion of the trust treated as owned by the beneficial owner under section 671.

(3) *Identifying the representative who will provide trust information.* The trustee must identify a representative of the WHFIT who will provide the information specified in this paragraph (c). The trustee also may identify an Internet website at which the trustee will provide the information specified in this paragraph (c). This information must be—

(i) Printed in a publication generally read by, and available to, requesting persons;

(ii) Stated in the trust's prospectus; or

(iii) Posted at the trustee's Internet website.

(4) *Time and manner of providing information*—(i) *Time*—(A) *In general*. Except as provided in paragraph (c)(4)(i)(B) of this section, a trustee must provide the information specified in this paragraph (c) to requesting persons on or before the later of—

(1) The 30th day after the close of the calendar year to which the request relates; or

(2) The day that is 14 days after the receipt of the request.

(B) *Trusts holding interests in other WHFITs or in REMICs*. If the WHFIT holds an interest in one or more other WHFITs or holds one or more REMIC regular interests, or holds both, a trustee must provide the information specified in this paragraph (c) to requesting persons on or before the later of—

(1) The 44th day after the close of the calendar year to which the request relates; or

(2) The day that is 28 days after the receipt of the request.

(ii) *Manner*. The information specified in this paragraph (c) must be provided—

(A) By written statement sent by first class mail to the address provided by the requesting person;

(B) By causing it to be printed in a publication generally read by and available to requesting persons and by notifying requesting persons in writing of the publication in which it will appear, the date on which it will appear, and, if possible, the page on which it will appear;

(C) By causing it to be posted at an Internet website, provided the trustee identifies the website under paragraph (c)(3) of this section;

(D) By electronic mail provided that the requesting person requests that the trustee furnish the information by electronic mail and the person furnishes an electronic address; or

(E) By any other method agreed to by the trustee and the requesting person.

(iii) *Inclusion of information with respect to all calculation periods*. If a trustee calculates WHFIT information using a calculation period other than a calendar year, the trustee must provide information for each calculation period that falls within the calendar year requested.

(5) *Requesting information from a WHFIT*—(i) *In general*. Requesting persons may request the information specified in this paragraph (c) from a WHFIT.

(ii) *Manner of requesting information*. In requesting WHFIT information, a requesting person must specify the WHFIT and the calendar year for which information is requested.

(iii) *Period of time during which a requesting person may request WHFIT information*. For the life of the WHFIT and for five years following the date of the WHFIT's termination, a requesting person may request the information specified in this paragraph (c) for any calendar year of the WHFIT's existence beginning with the 2007 calendar year.

(6) *Trustee's requirement to retain records*. For the life of the WHFIT and for five years following the date of termination of the WHFIT, the trustee must maintain in its records a copy of the information required to be provided to requesting persons this paragraph (c) for each calendar year beginning with the 2007 calendar year. For a period of five years following the close of the calendar year to which the data pertains, the trustee also must maintain in its records such supplemental data as may be necessary to establish that the information provided to requesting persons is correct and meets the requirements of this paragraph (c).

(d) *Form 1099 requirement for trustees and middlemen*—(1) *Obligation to file Form 1099 with the IRS*—(i) *In general*. Except as provided in paragraphs (d)(1)(ii) and (iii) of this section—

(A) The trustee must file with the IRS the appropriate Forms 1099, reporting the information specified in paragraph (d)(2) of this section with respect to any TIH who holds an interest in the WHFIT directly and not through a middleman; and

(B) Every middleman must file with the IRS the appropriate Forms 1099, reporting the information specified in

paragraph (d)(2) of this section with respect to any TIH on whose behalf or account the middleman holds an interest in the WHFIT or acts as an intermediary.

(ii) *Forms 1099 not required for exempt recipients*—(A) *In general.* A Form 1099 is not required with respect to a TIH who is an exempt recipient (as defined in paragraph (b)(7) of this section), unless the trustee or middleman backup withholds under section 3406 on payments made to an exempt recipient (because, for example, the exempt recipient has failed to furnish a Form W-9 on request). If the trustee or middleman backup withholds, then the trustee or middleman is required to file a Form 1099 under this paragraph (d) unless the trustee or middleman refunds the amount withheld in accordance with § 31.6413(a)-3 of this chapter.

(B) *Exempt recipients must include WHFIT information in computing taxable income.* A beneficial owner who is an exempt recipient must obtain WHFIT information and must include the items (as defined in paragraph (b)(9) of this section) of the WHFIT in computing its taxable income on its federal income tax return. Paragraphs (c)(3) and (h) of this section provide rules for exempt recipients to obtain information from a WHFIT.

(iii) *Reporting and withholding with respect to foreign persons.* The items of the WHFIT attributable to a TIH who is not a United States person must be reported, and amounts must be withheld, as provided under subtitle A, chapter 3 of the Internal Revenue Code (sections 1441 through 1464) and the regulations thereunder and not reported under this paragraph (d).

(2) *Information to be reported*—(i) *Determining amounts to be provided on Forms 1099.* The amounts reported to the IRS for a calendar year by a trustee or middleman on the appropriate Form 1099 must be consistent with the information provided by the trustee under paragraph (c) of this section and must reflect with reasonable accuracy the amount of each item required to be reported on a Form 1099 that is attributable (or if permitted under paragraphs (d)(2)(ii)(D) and (E) of this section, distributed) to the TIH. If the trustee, in providing WHFIT informa-

tion, uses the safe harbors in paragraph (f)(1) or (g)(1) of this section, then the trustee or middleman must calculate the information to be provided to the IRS on the Forms 1099 in accordance with paragraph (f)(2) or (g)(2) of this section, as appropriate.

(ii) *Information to be provided on Forms 1099.* The trustee or middleman must include on the appropriate Forms 1099:

(A) *Taxpayer information.* The name, address, and taxpayer identification number of the TIH;

(B) *Information regarding the person filing the Form 1099.* The name, address, taxpayer identification number, and telephone number of the person required to file the Form 1099;

(C) *Gross income.* All items of gross income of the WHFIT attributable to the TIH for the calendar year (including OID (unless the exception for certain WHMTs applies (see paragraph (c)(2)(ii)(A) of this section)) and all amounts of income attributable to a selling, purchasing, or redeeming TIH for the portion of the calendar year that the TIH held its interest (unless paragraph (c)(2)(v)(C) of this section (regarding an exception for certain NMWHFITs) applies));

(D) *Non pro-rata partial principal payments.* All non pro-rata partial principal payments (as defined in paragraph (b)(13) of this section) received by the WHFIT that are attributable (or distributed, in the case of a trustee or middleman reporting under paragraph (f)(2)(iii) of this section) to the TIH;

(E) *Trust sales proceeds.* All trust sales proceeds (as defined in paragraph (b)(21) of this section) that are attributable to the TIH for the calendar year, if any, or, if paragraph (c)(2)(iv)(B) of this section (regarding certain NMWHFITs) applies, the amount of trust sales proceeds distributed to the TIH for the calendar year;

(F) *Reporting Redemptions.* All redemption asset proceeds (as defined in paragraph (b)(14) of this section) paid to the TIH for the calendar year, if any, or, if paragraph (c)(2)(v)(C) of this section (regarding an exception for certain NMWHFITs) applies, all redemption proceeds (as defined in paragraph (b)(15) of this section) paid to the TIH for the calendar year;

(G) *Reporting sales of a trust interest on a secondary market.* All sales asset proceeds (as defined in paragraph (b)(17) of this section) paid to the TIH for the sale of a trust interest or interests on a secondary market established for the NMWHFIT for the calendar year, if any, or, if paragraph (c)(2)(v)(C) of this section (regarding an exception for certain NMWHFITs) applies, all sales proceeds (as defined in paragraph (b)(18) of this section) paid to the TIH for the calendar year; and

(H) *Other information.* Any other information required by the Form 1099.

(3) *Time and manner of filing Forms 1099—(i) Time and place.* The Forms 1099 required to be filed under this paragraph (d) must be filed on or before February 28 (March 31, if filed electronically) of the year following the year for which the Forms 1099 are being filed. The returns must be filed with the appropriate Internal Revenue Service Center, at the address listed in the instructions for the Forms 1099. For extensions of time for filing returns under this section, see §1.6081-1, the instructions for the Forms 1099, and applicable revenue procedures (see §601.601(d)(2) of this chapter). For magnetic media filing requirements, see §301.6011-2 of this chapter.

(ii) *Reporting trust sales proceeds, redemption asset proceeds, redemption proceeds, sale asset proceeds, sales proceeds and non pro-rata partial principal payments—(A) Form to be used.* Trust sales proceeds, redemption asset proceeds, redemption proceeds, sale asset proceeds, sales proceeds, and non pro-rata partial principal payments are to be reported on the same type of Form 1099 as that required for reporting gross proceeds under section 6045.

(B) *Appropriate reporting for in-kind redemptions.* The value of the assets distributed with respect to an in-kind redemption is not required to be reported to the IRS. Unless paragraph (c)(2)(v)(C) of this section applies, the trustee or middleman must report the gross income attributable to the redeemed trust interest for the calendar year up to the date of the redemption under paragraph (d)(2)(ii)(C) of this section.

(e) *Requirement to furnish a written tax information statement to the TIH—(1) In*

*general.* Every trustee or middleman required to file appropriate Forms 1099 under paragraph (d) of this section with respect to a TIH must furnish to that TIH (the person whose identifying number is required to be shown on the form) a written tax information statement showing the information described in paragraph (e)(2) of this section. The amount of a trust item reported to a TIH under this paragraph (e) must be consistent with the information reported to the IRS with respect to the TIH under paragraph (d) of this section. Information provided in this written statement must be determined in accordance with the rules provided in paragraph (d)(2)(i) of this section (regardless of whether the information was required to be provided on a Form 1099). Further, the trustee or middleman must separately state on the written tax information statement any items that, if taken into account separately by that TIH, would result in an income tax liability that is different from the income tax liability that would result if the items were not taken into account separately.

(2) *Information required.* For the calendar year, the written tax information statement must meet the following requirements:

(i) *WHFIT information.* The written tax information statement must include the name of the WHFIT and the identifying number of the WHFIT;

(ii) *Identification of the person furnishing the statement.* The written tax information statement must include the name, address, and taxpayer identification number of the person required to furnish the statement;

(iii) *Items of income, expense, and credit.* The written tax information statement must include information regarding the items of income (that is, the information required to be reported to the IRS on Forms 1099), expense (including affected expenses), and credit that are attributable to the TIH for the calendar year;

(iv) *Non pro-rata partial principal payments.* The written tax information statement must include the information required to be reported to the IRS on Forms 1099 under paragraph (d)(2)(ii)(D) of this section (regarding

the non pro-rata partial principal payments that are attributable (or distributed, in the case of a trustee or middleman reporting under paragraph (f)(2)(iii) of this section) to the TIH for the calendar year).

(v) *Asset sales and dispositions*—(A) *General rule.* Unless paragraph (c)(2)(iv)(B) (regarding the exception for certain NMWHFITs) or (c)(2)(iv)(C) (regarding the exception for certain WHMTs) of this section applies, the written tax information statement must include, with respect to each sale or disposition of a WHFIT asset for the calendar year—

(1) The date of sale or disposition;

(2) Information regarding the trust sales proceeds that are attributable to the TIH as a result of the sale or disposition; and

(3) Information that will enable the TIH to allocate with reasonable accuracy a portion of the TIH's basis in the TIH's trust interest to the sale or disposition.

(B) *Special rule for certain NMWHFITs and WHMTs.* In the case of a NMWHFIT to which paragraph (c)(2)(iv)(B) of this section applies or in the case of a WHMT to which paragraph (c)(2)(iv)(C) of this section applies, the written tax information statement must include, with respect to asset sales and dispositions, only the information required to be reported to the IRS on Form 1099 under paragraph (d)(2)(ii)(E) of this section.

(vi) *Redemption or sale of a trust interest.* The written tax information statement must include the information required to be reported to the IRS on Forms 1099 under paragraphs (d)(2)(ii)(F) and (G) of this section (regarding the sales and redemptions of trust interests made by the TIH for the calendar year);

(vii) *Information regarding market discount and bond premium.* The written tax information statement must include the information required to be reported by the trustee under paragraphs (c)(2)(vi) and (vii) of this section (regarding bond premium and market discount);

(viii) *Other information.* The written tax information statement must include any other information necessary for the TIH to report, with reasonable

accuracy for the calendar year, the items (as defined in paragraph (b)(9) of this section) attributable to the portion of the trust treated as owned by the TIH under section 671. The written tax information statement may include information with respect to a trust item on a per trust interest basis if the trustee has reported (or calculated) the information with respect to that item on a per trust interest basis and information with respect to that item is not required to be reported on a Form 1099; and

(ix) *Required statement.* The written tax information statement must inform the TIH that the items of income, deduction, and credit, and any other information shown on the statement must be taken into account in computing the taxable income and credits of the TIH on the Federal income tax return of the TIH. If the written tax information statement reports that an amount of qualified dividend income is attributable to the TIH, the written tax information statement also must inform the TIH that the TIH must meet the requirements of section 1(h)(11)(B)(iii) to treat the dividends as qualified dividends.

(3) *Due date and other requirements.* The written tax information statement must be furnished to the TIH on or before March 15 of the year following the calendar year for which the statement is being furnished.

(4) *Requirement to retain records.* For a period of no less than five years from the due date for furnishing the written tax information statement, a trustee or middleman must maintain in its records a copy of any written tax information statement furnished to a TIH, and such supplemental data as may be required to establish the correctness of the statement.

(f) *Safe harbor for providing information for certain NMWHFITs*—(1) *Safe harbor for trustee reporting of NMWHFIT information.* The trustee of a NMWHFIT that meets the requirements of paragraph (f)(1)(i) of this section is deemed to satisfy paragraph (c)(1)(i) of this section, if the trustee calculates and provides WHFIT information in the manner described in this paragraph (f) and provides a statement to a requesting person giving notice that information

has been calculated in accordance with this paragraph (f)(1).

(i) *In general—(A) Eligibility to report under this safe harbor.* Only NMWHFITs that meet the requirements set forth in paragraphs (f)(1)(i)(A)(I) and (2) of this section may report under this safe harbor. For purposes of determining whether the requirements of paragraph (f)(1)(i)(A)(I) of this section are met, trust sales proceeds and gross proceeds from sales described in paragraphs (c)(2)(iv)(G) and (H) of this section are ignored.

(I) Substantially all of the NMWHFIT's income is from dividends or interest; and

(2) All trust interests have identical value and rights.

(B) *Consistency requirements.* The trustee must—

(1) Calculate all trust items subject to the safe harbor consistent with the safe harbor; and, (2) Report under this paragraph (f)(1) for the life of the NMWHFIT; or, if the NMWHFIT has a start-up date before January 1, 2007, the NMWHFIT must begin reporting under this paragraph (f)(1) as of January 1, 2007 and must continue to report under this paragraph for the life of the NMWHFIT.

(ii) *Reporting NMWHFIT income and expenses.* A trustee must first determine the total amount of NMWHFIT distributions (both actual and deemed) for the calendar year and then express each income or expense item as a fraction of the total amount of NMWHFIT distributions. These fractions (hereinafter referred to as factors) must be accurate to at least four decimal places.

(A) *Step One: Determine the total amount of NMWHFIT distributions for the calendar year.* The trustee must determine the total amount of NMWHFIT distributions (actual and deemed) for the calendar year. If the calculation of the total amount of NMWHFIT distributions under this paragraph (f)(1)(ii)(A) results in a zero or a negative number, the trustee may not determine income and expense information under this paragraph (f)(1)(ii)(A) (but may report all other applicable items under this paragraph (f)(1)). The total amount of NMWHFIT distributions equals the amount of NMWHFIT funds paid out to all TIHs (including

all trust sales proceeds, all principal receipts, and all redemption proceeds) for the calendar year—

(I) Increased by—

(i) All amounts that would have been distributed during the calendar year, but were instead reinvested pursuant to a reinvestment plan; and

(ii) All cash held for distribution to TIHs as of December 31 of the year for which the trustee is reporting; and

(2) Decreased by—

(i) All cash distributed during the current year that was included in a year-end cash allocation factor (see paragraph (f)(1)(ii)(C)(I) of this section) for a prior year;

(ii) All redemption asset proceeds paid for the calendar year, or if paragraph (c)(2)(v)(C) of this section applies to the NMWHFIT, all redemption proceeds paid for the calendar year;

(iii) All trust sales proceeds distributed during the calendar year; and

(iv) All non pro-rata partial principal payments distributed during the calendar year.

(3) For the purpose of determining the amount of all redemption asset proceeds or redemption proceeds paid for the calendar year with respect to paragraph (f)(1)(ii)(A)(2)(ii) of this section, the value of the assets (not including cash) distributed with respect to an in-kind redemption is disregarded. Any cash distributed as part of the redemption must be included in the total amount of NMWHFIT distributions.

(B) *Step Two: Determine factors that express the ratios of NMWHFIT income and expenses to the total amount of NMWHFIT distributions.* The trustee must determine factors that express the ratios of NMWHFIT income and expenses to the total amount of NMWHFIT distributions as follows:

(1) *Income factors.* For each item of income generated by the NMWHFIT's assets for the calendar year, the trustee must determine the ratio of the gross amount of that item of income to the total amount of NMWHFIT distributions for the calendar year; and

(2) *Expense factors.* For each item of expense paid by a NMWHFIT during the calendar year, the trustee must determine the ratio of the gross amount of that item of expense to the total

amount of NMWHFIT distributions for the calendar year.

(C) *Step Three: Determine adjustments for reconciling the total amount of NMWHFIT distributions (determined under Step One) with amounts actually paid to TIHs.* Paragraph (f)(1)(ii)(B) of this section (Step Two) requires an item of income or expense to be expressed as a ratio of that item to the total amount of NMWHFIT distributions as determined in paragraph (f)(1)(ii)(A) of this section (Step One). A TIH's share of the total amount of NMWHFIT distributions may differ from the amount actually paid to that TIH. A trustee, therefore, must provide information that can be used to compute a TIH's share of the total amount of NMWHFIT distributions based on the amount actually paid to the TIH. A trustee satisfies this requirement by providing a current year-end cash allocation factor, a prior year cash allocation factor, and the date on which the prior year cash was distributed to TIHs (prior year cash distribution date).

(1) *The current year-end cash allocation factor.* The current year-end cash allocation factor is the amount of cash held for distribution to TIHs by the NMWHFIT as of December 31 of the calendar year for which the trustee is reporting, divided by the number of trust interests outstanding as of that date.

(2) *The prior year cash allocation factor.* The prior year cash allocation factor is the amount of the distribution during the calendar year for which the trustee is reporting that was included in determining a year-end cash allocation factor for a prior year, divided by the number of trust interests outstanding on the date of the distribution.

(iii) *Reporting non pro-rata partial principal payments under the safe harbor.* The trustee must provide a list of dates on which non pro-rata partial principal payments were distributed by the trust, and the amount distributed, per trust interest.

(iv) *Reporting sales and dispositions of NMWHFIT assets under the safe harbor—(A) NMWHFITs that must report under the general rule—(1) In general.* If a NMWHFIT must report under the general rule of paragraph (c)(2)(iv)(A) of

this section, the trustee must provide a list of dates (from earliest to latest) on which sales or dispositions of NMWHFIT assets occurred during the calendar year for which the trustee is reporting and, for each date identified, provide—

(i) The trust sales proceeds received by the trust, per trust interest, with respect to the sales and dispositions, on that date;

(ii) The trust sales proceeds distributed to TIHs, per trust interest, with respect to the sales and dispositions on that date, and the date that the trust sales proceeds were distributed to the TIHs; and

(iii) The ratio (expressed as a percentage) of the assets sold or disposed of on that date to all assets held by the NMWHFIT.

(2) *Determination of the portion of all assets held by the NMWHFIT that the assets sold or disposed of represented—*

(i) If a NMWHFIT terminates within twenty-four months of its start-up date, the ratio of the assets sold or disposed of on that date to all assets held by the NMWHFIT is based on the fair market value of the NMWHFIT's assets as of the start-up date; or

(ii) If a NMWHFIT terminates more than twenty-four months after its start-up date, the ratio of the assets sold or disposed of on that date to all assets held by the NMWHFIT is based on the fair market value of the NMWHFIT's assets as of the date of the sale or disposition.

(B) *NMWHFITs excepted from the general rule.* If paragraph (c)(2)(iv)(B) of this section applies to the NMWHFIT, the trustee must provide a list of dates on which trust sales proceeds were distributed, and the amount of trust sales proceeds, per trust interest, that were distributed on that date. The trustee also must also provide requesting persons with the statement required by paragraph (c)(2)(iv)(B) of this section.

(v) *Reporting redemptions under the safe harbor—(A) In general.* The trustee must:

(1) Provide a list of dates on which the amount of redemption proceeds paid for the redemption of a trust interest was determined and the amount of the redemption asset proceeds determined per trust interest on that date,

or if paragraph (c)(2)(v)(C) of this section applies to the NMWHFIT, the amount of redemption proceeds determined on that date; or

(2) Provide to each requesting person that held (either for its own behalf or for the behalf of a TIH) a trust interest that was redeemed during the calendar year, the date of the redemption and the amount of the redemption asset proceeds per trust interest determined on that date, or if paragraph (c)(2)(v)(C) of this section applies to the NMWHFIT, the amount of the redemption proceeds determined for that date; and

(B) *Paragraph (c)(2)(v)(C) statement.* If paragraph (c)(2)(v)(C) of this section applies to the NMWHFIT, the trustee must provide a statement to requesting persons to the effect that the trustee is providing information consistent with paragraph (c)(2)(v)(C) of this section.

(vi) *Reporting the sale of a trust interest under the safe harbor.* If paragraph (c)(2)(v)(C) of this section does not apply to the NMWHFIT, the trustee must provide, for each day of the calendar year, the amount of cash held for distribution, per trust interest, by the NMWHFIT on that date. If the trustee is able to identify the date on which trust interests were sold on the secondary market, the trustee alternatively may provide information for each day on which sales of trust interests occurred rather than for each day during the calendar year. If paragraph (c)(2)(v)(C) of this section applies to the NMWHFIT, the trustee is not required to provide any information under this paragraph (f)(1)(vi), other than a statement that the NMWHFIT meets the requirements to report under paragraph (c)(2)(v)(C) of this section.

(vii) *Reporting OID information under the safe harbor.* The trustee must provide, for each calculation period, the average aggregate daily accrual of OID per \$1,000 of original principal amount.

(viii) *Reporting market discount information under the safe harbor—(A) In general—(1) Trustee required to provide market discount information.* If the trustee is required to provide information regarding market discount under paragraph (c)(2)(vii) of this section, the trustee must provide—

(i) The information required to be provided under paragraph (f)(1)(iv)(A)(I)(iii) of this section; and

(ii) If the NMWHFIT holds debt instruments with OID, a list of the aggregate adjusted issue prices of the debt instruments per trust interest calculated as of the start-up date or measuring date (see paragraph (c)(2)(iv)(D)(4) of this section) (whichever provides more accurate information) and as of January 1 for each subsequent year of the NMWHFIT.

(2) *Trustee not required to provide market discount information.* If the trustee is not required to provide market discount information under paragraph (c)(2)(vii) of this section (because the NMWHFIT meets the general de minimis test of paragraph (c)(2)(iv)(D)(I) of this section, the qualified NMWHFIT exception of paragraph (c)(2)(iv)(E) of this section, or the NMWHFIT final year exception of paragraph (c)(2)(iv)(F) of this section), the trustee is not required under this paragraph (f) to provide any information regarding market discount.

(B) *Reporting market discount information under the safe harbor when the yield of the debt obligations held by the WHFIT is expected to be affected by prepayments.* [Reserved]

(ix) *Reporting bond premium information under the safe harbor.* [Reserved]

(x) *Reporting additional information.* If a requesting person cannot use the information provided by the trustee under paragraphs (f)(1)(ii) through (ix) of this section to determine with reasonable accuracy the trust items that are attributable to a TIH, the requesting person must request, and the trustee must provide, additional information to enable the requesting person to determine the trust items that are attributable to the TIH. See, for example, paragraph (f)(2)(ii)(A)(4) of this section which requires a middleman to request additional information from the trustee when the total amount of WHFIT distributions attributable to a TIH equals zero or less.

(2) *Use of information provided by trustees under the safe harbor for NMWHFITs—(i) In general.* If a trustee reports NMWHFIT items in accordance with paragraph (f)(1) of this section, the information provided with respect

to those items on the Forms 1099 required under paragraph (d) of this section to be filed with the IRS and on the statement required under paragraph (e) of this section to be furnished to the TIH must be determined as provided in this paragraph (f)(2).

(ii) *Determining NMWHFIT income and expense under the safe harbor.* The trustee or middleman must determine the amount of each item of income and expense attributable to a TIH as follows—

(A) *Step One: Determine the total amount of NMWHFIT distributions attributable to the TIH.* To determine the total amount of NMWHFIT distributions attributable to a TIH for the calendar year, the total amount paid to, or credited to the account of, the TIH during the calendar year (including amounts paid as trust sales proceeds or partial non-pro rata principal payments, redemption proceeds, and sales proceeds) is—

(1) Increased by—

(i) All amounts that would have been distributed during the calendar year to the TIH, but that were reinvested pursuant to a reinvestment plan (unless another person (for example, the custodian of the reinvestment plan) is responsible for reporting these amounts under paragraph (d) of this section); and

(ii) An amount equal to the current year-end cash allocation factor (provided by the trustee in accordance with paragraph (f)(1)(ii)(C)(1) of this section) multiplied by the number of trust interests held by the TIH as of December 31 of the calendar year for which the trustee is reporting; and

(2) Decreased by—

(i) An amount equal to the prior year cash allocation factor (provided by the trustee in accordance with paragraph (f)(1)(ii)(C)(2) of this section) multiplied by the number of trust interests held by the TIH on the date of the distribution;

(ii) An amount equal to all redemption asset proceeds paid to the TIH for the calendar year, or if paragraph (c)(2)(v)(C) of this section applies to the NMWHFIT, an amount equal to all redemption proceeds paid to the TIH for the calendar year;

(iii) An amount equal to all sale asset proceeds paid to the TIH for the calendar year, or if paragraph (c)(2)(v)(C) of this section applies to the NMWHFIT, the amount of sales proceeds paid to the TIH for the calendar year;

(iv) In the case of a TIH that purchased a trust interest in a NMWHFIT to which paragraph (c)(2)(v)(C) of this section does not apply, an amount equal to the cash held for distribution per trust interest on the date that the TIH acquired its interest, multiplied by the trust interests acquired on that date;

(v) The amount of the trust sales proceeds distributed to the TIH, calculated as provided in paragraph (f)(2)(iv)(A)(3) of this section; and

(vi) The amount of non pro-rata partial principal prepayments distributed to the TIH during the calendar year, calculated as provided in paragraph (f)(2)(iii) of this section.

(3) *Treatment of in-kind distributions under this paragraph (f)(2)(i).* The value of the assets (not including cash) received with respect to an in-kind redemption is not included in the amount used in paragraph (f)(2)(ii)(A)(2)(ii) of this section. The cash distributed as part of the redemption, however, must be included in the total amount of NMWHFIT distributions paid to the TIH.

(4) *The total amount of distributions attributable to a TIH calculated under this paragraph (f)(2)(i)(A) equals zero or less.* If the total amount of distributions attributable to a TIH, calculated under this paragraph (f)(2)(i)(A), equals zero or less, the trustee or middleman may not report the income and expense attributable to the TIH under this paragraph (f)(2)(i). The trustee or middleman must request additional information from the trustee of the NMWHFIT to enable the trustee or middleman to determine with reasonable accuracy the items of income and expense that are attributable to the TIH. The trustee or middleman must report the other items subject to paragraph (f)(1) of this section in accordance with this paragraph (f)(2).

(B) *Step Two: Apply the factors provided by the trustee to determine the items*

of income and expense that are attributable to the TIH. The amount of each item of income (other than OID) and each item of expense attributable to a TIH is determined as follows—

(1) *Application of income factors.* For each income factor, the trustee or middleman must multiply the income factor by the total amount of NMWHFIT distributions attributable to the TIH for the calendar year (as determined in paragraph (f)(2)(i)(A) of this section).

(2) *Application of expense factors.* For each expense factor, the trustee or middleman must multiply the expense factor by the total amount of NMWHFIT distributions attributable to the TIH for the calendar year (as determined in paragraph (f)(2)(i)(A) of this section).

(iii) *Reporting non pro-rata partial principal payments under the safe harbor.* To determine the amount of non pro-rata partial principal payments that are distributed to a TIH for the calendar year, the trustee or middleman must aggregate the amount of non pro-rata partial principal payments distributed to a TIH for each day that non pro-rata principal payments were distributed. To determine the amount of non pro-rata principal payments that are distributed to a TIH on each distribution date, the trustee or middleman must multiply the amount of non pro rata principal payments per trust interest distributed on that date by the number of trust interests held by the TIH.

(iv) *Reporting sales and dispositions of NMWHFIT assets under the safe harbor—*  
(A) *Reporting under the safe harbor if the general rules apply to the NMWHFIT.* Unless paragraph (c)(2)(iv)(B) of this section applies, the trustee or middleman must comply with paragraphs (f)(2)(iv)(A)(1), (2), and (3) of this section.

(1) *Form 1099.* The trustee or middleman must report the amount of trust sales proceeds attributable to the TIH for the calendar year on Form 1099. To determine the amount of trust sales proceeds attributable to a TIH for the calendar year, the trustee or middleman must aggregate the total amount of trust sales proceeds attributable to the TIH for each date on which the NMWHFIT sold or disposed of an asset

or assets. To determine the total amount of trust sales proceeds attributable to a TIH for each date that the NMWHFIT sold or disposed of an asset or assets, the trustee or middleman multiplies the amount of trust sales proceeds received by the NMWHFIT per trust interest on that date by the number of trust interests held by the TIH on that date.

(2) *The written tax information statement furnished to the TIH.* The written tax information statement required to be furnished to the TIH under paragraph (e) of this section must include a list of dates (in order, from earliest to latest) on which sales or dispositions of trust assets occurred during the calendar year and provide, for each date identified—

(i) The trust sales proceeds received by the trust, per trust interest, with respect to the sales or dispositions of trust assets on that date; and

(ii) The information provided by the trustee under paragraph (f)(1)(iv)(B)(2) of this section regarding the ratio of the assets sold or disposed of on that date to all the assets of the NMWHFIT held on that date, prior to such sale or disposition.

(3) *Calculating the total amount of trust sales proceeds distributed to the TIH.* To determine the total amount of NMWHFIT distributions attributable to a TIH, the trustee or middleman must calculate the amount of trust sales proceeds distributed to the TIH for the calendar year. (See paragraph (f)(2)(ii)(A)(2)(v) of this section.) To determine the amount of trust sales proceeds distributed to a TIH for the calendar year, the trustee or middleman must aggregate the total amount of trust sales proceeds distributed to the TIH for each date on which the NMWHFIT distributed trust sales proceeds. To determine the total amount of trust sales proceeds distributed to a TIH for each date that the NMWHFIT distributed trust sales proceeds, the trustee or middleman must multiply the amount of trust sales proceeds distributed by the NMWHFIT per trust interest on that date by the number of trust interests held by the TIH on that date.

(B) *Reporting under the safe harbor if paragraph (c)(2)(iv)(B) of this section applies to the NMWHFIT.* If paragraph (c)(2)(iv)(B) of this section applies, the trustee or middleman must calculate, in the manner provided in paragraph (f)(2)(iv)(A)(3) of this section, the amount of trust sales proceeds distributed to the TIH for the calendar year. The trustee or middleman must report this amount on the Form 1099 filed for the TIH and on the written tax information statement furnished to the TIH.

(v) *Reporting redemptions under the safe harbor—*(A) Except as provided in paragraph (f)(2)(v)(B) or (C) of this section, if the trustee has provided a list of dates for which the amount of the redemption proceeds to be paid for the redemption of a trust interest was determined and the redemption asset proceeds paid for that date, the trustee or middleman must multiply the redemption asset proceeds determined per trust interest for that date by the number of trust interests redeemed by the TIH on that date.

(B) If paragraph (c)(2)(v)(C) of this section applies, and the trustee has provided a list of dates for which the amount of the redemption proceeds to be paid for the redemption of a trust interest was determined and the redemption proceeds determined per trust interest on each date, the trustee or middleman must multiply the redemption proceeds per trust interest for each date by the number of trust interests redeemed by the TIH on that date.

(C) If the trustee has provided the requesting person with information regarding the redemption asset proceeds paid for each redemption of a trust interest held by the middleman for the calendar year, or if paragraph (c)(2)(v)(C) of this section applies and the trustee has provided the amount of redemption proceeds paid for each redemption of a trust interest held by the middleman during the calendar year, the requesting person may use this information to determine the amount of the redemption asset proceeds or redemption proceeds paid to the TIH for the calendar year.

(vi) *Reporting sales of trust interests under the safe harbor—*(A) Except as

provided in paragraph (f)(2)(vi)(B) of this section, the trustee or middleman must subtract the amount of cash held for distribution per trust interest on the date of the sale from the sales proceeds paid to the TIH to determine the sale asset proceeds that are to be reported to the TIH for each sale of a trust interest.

(B) If paragraph (c)(2)(v)(C) of this section applies, the trustee or middleman must report the sales proceeds paid to the TIH as a result of each sale of a trust interest.

(vii) *Reporting OID information under the safe harbor—*The trustee or middleman must aggregate the amounts of OID that are allocable to each trust interest held by a TIH for each calculation period. The amount of OID that is allocable to a trust interest, with respect to each calculation period, is determined by multiplying—

(A) The product of the OID factor and the original principal balance of the trust interest, divided by 1,000; by

(B) The number of days during the OID calculation period in that calendar year that the TIH held the trust interest.

(viii) *Reporting market discount information under the safe harbor—*(A) Except as provided in paragraph (f)(2)(viii)(B) of this section, the trustee or middleman must provide the TIH with the information provided under paragraph (f)(1)(viii) of this section.

(B) If paragraph (c)(2)(iv)(B) of this section applies, the trustee and middleman are not required under this paragraph (f)(2) to provide any information regarding market discount.

(ix) *Reporting bond premium information under the safe harbor.* [Reserved]

(3) *Example of the use of the safe harbor for NMWHFITs.* The following example illustrates the use of the factors in this paragraph (f) to calculate and provide NMWHFIT information:

*Example: (i) Facts—*(A) *In general—*(1) Trust is a NMWHFIT that holds common stock in ten different corporations and has 100 trust interests outstanding. The start-up date for Trust is December 15, 2006, and Trust's registration statement under the Securities Act of 1933 became effective after July 31, 2006. Trust terminates on March 15, 2008. The agreement governing Trust requires Trust to distribute cash held by Trust reduced by accrued but unpaid expenses on April 15, July

15, and October 15 of the 2007 calendar year. The agreement also provides that the trust interests will be redeemed by the Trust for an amount equal to the value of the trust interest, as of the close of business, on the day the trust interest is tendered for redemption. There is no reinvestment plan. A secondary market for interests in Trust will be created by Trust's sponsor and Trust's sponsor will provide Trustee with a list of dates on which sales occurred on this secondary market.

(2) As of December 31, 2006, Trust holds \$12x for distribution to TIHs on the next distribution date and has no accrued but unpaid expenses. Trustee includes the \$12x in determining the year-end cash allocation factor for December 31, 2006.

(B) *Events occurring during the 2007 calendar year*—(1) As of January 1, 2007, Broker1 holds ten trust interests in Trust in street name for each of J and A and Broker2 holds ten trust interests in Trust in street name for S. J, A, and S; are individual, cash method taxpayers.

(2) As of January 1, 2007, the fair market value of the Trust's assets equals \$10,000x.

(3) During 2007, Trust receives \$588x in dividend income. Trustee determines that \$400x of the dividend income received during 2007 meets the definition of a qualified dividend in section 1(h)(11)(B)(i) and the holding period requirement in section 1(h)(11)(B)(iii) with respect to the Trust. During 2007, Trust also receives \$12x in interest income from investment of Trust's funds pending distribution to TIHs, and pays \$45x in expenses, all of which are affected expenses.

(4) On April 15, 2007, Trustee distributes \$135x, which includes the \$12x included in determining the year-end cash allocation factor for December 31, 2006. As a result of the distribution, Broker1 credits J's account and A's account for \$13.50x each. Broker2 credits S's account for \$13.50x.

(5) On June 1, 2007, Trustee sells shares of stock for \$1000x to preserve the soundness of the trust. The stock sold on June 1, 2007, equaled 20% of the aggregate fair market value of the assets held by Trust on the start-up date of Trust. Trustee has chosen not to report sales described in paragraph (c)(2)(iv)(4)(ii) of Trust's assets under paragraph (c)(2)(iv)(D)(4) of this section.

(6) On July 15, 2007, Trustee distributes \$1.135x, which includes the \$1.000x of trust sales proceeds received by Trust for the sale of assets on June 1, 2007. As a result of the distribution, Broker1 credits J's account and

A's account for \$113.50x each. Broker 2 credits S's account for \$113.50x.

(7) On September 30 2007, J, through Trust's sponsor, sells a trust interest to S for \$115.35x. Trustee determines that the cash held for distribution per trust interest on September 30 is \$1.35x. As a result of the sale, Broker1 credits J's account for \$115.35x.

(8) On October 15, 2007, Trustee distributes \$123x. As a result of the distribution, Broker1 credits J's account for \$11.07x and A's account for \$12.30x. Broker2 credits S's account for \$13.53x.

(9) On December 10, 2007, J tenders a trust interest to Trustee for redemption through Broker1. Trustee determines that the amount of the redemption proceeds to be paid for a trust interest that is tendered for redemption on December 10, 2007 is \$116x, of which \$115x represents the redemption asset proceeds. Trustee pays this amount to Broker1 on J's behalf. On December 12, 2007, trustee engages in a non pro-rata sale of shares of common stock for \$115x to effect J's redemption of a trust interest. The stock sold on December 12, 2007, equals 2% of the aggregate fair market value of all the assets of Trust as of the start-up date.

(10) On December 10, 2007, J, through Trust's sponsor, also sells a trust interest to S for \$116x. Trustee determines that the cash held for distribution per trust interest on that date is \$1x. As a result of the sale, Broker1 credits J's account for \$116x.

(11) As of December 31, 2007, Trust holds cash of \$173x and has incurred \$15x in expenses that Trust has not paid. J is the only TIH to redeem a trust interest during the calendar year. The sale of two trust interests in Trust by J to S are the only sales that occurred on the secondary market established by Trust's sponsor during 2007.

(ii) *Trustee reporting*—(A) *Summary of information provided by Trustee.* Trustee meets the requirements of paragraph (f)(1) of this section if Trustee provides the following information to requesting persons:

(1) *Income and expense information:*

Factor for ordinary dividend income .....	0.3481
Factor for qualified dividend income .....	0.7407
Factor for interest income .....	0.0222
Factor for affected expenses .....	0.0833
Current year-end cash allocation factor .....	1.5960
Prior year cash allocation factor .....	0.1200
Prior year cash distribution date .....	April 15

(2) *Information regarding asset sales and distributions:*

Date of sale	Trust sales proceeds received	Trust sales proceeds distributed and date distributed	Percent of trust sold
June 1 .....	\$10.0000x .....	\$10.0000x (July 15) .....	20
December 12 .....	1.1616x .....	0.0000x .....	2

§ 1.671-5

26 CFR Ch. I (4-1-12 Edition)

(3) Information regarding redemptions:

Date	Redemption asset proceeds
December 10 .....	\$115x

(4) Information regarding sales of trust interests

Date	Cash held for distribution per trust interest
September 30 .....	\$1.35x
December 10 .....	1.00x

(B) Trustee determines this information as follows:

(1) *Step One: Trustee determines the total amount of NMWHFIT distributions for the calendar year.* The total amount of NMWHFIT distributions (actual and deemed) for the calendar year for purposes of determining the safe harbor factors is \$540x. This amount consists of the amounts paid on each scheduled distribution date during the calendar year (\$1135x, \$135x, and \$123x), plus the total amount paid to J as a result of J's redemption of a trust interest (\$116x) (\$1,135x + \$135x + \$123x + \$116x = \$1,509x)—

(i) Increased by all cash held for distribution to TIHs as of December 31, 2007 (\$158x), which is the cash held as of December 31, 2007 (\$173x) reduced by the accrued but unpaid expenses as of December 31, 2007 (\$15x), and

(ii) Decreased by all amounts distributed during the calendar year but included in the year-end cash allocation factor from a prior year (\$12x); all redemption asset proceeds paid for the calendar year (\$115x); and all trust sales proceeds distributed during the calendar year (\$1,000x).

(2) *Step Two: Trustee determines factors that express the ratio of NMWHFIT income (other than OID) and expenses to the total amount of NMWHFIT distributions.* Trustee determines the factors for each item of income earned by Trust and each item of expense as follows:

(i) *Ordinary dividend income factor.* The ordinary dividend income factor is 0.3481, which represents the ratio of the gross amount of ordinary dividends (\$188x) to the total amount of NMWHFIT distributions for the calendar year (\$540x).

(ii) *Qualified dividend income factor.* The qualified dividend income factor is 0.7407 which represents the ratio of the gross amount of qualified dividend income (\$400x) to the total amount of NMWHFIT distributions for the calendar year (\$540x).

(iii) *Interest income factor.* The interest income factor is 0.0222, which represents the ratio of the gross amount of interest income (\$12x) to the total amount of NMWHFIT distributions for the calendar year (\$540x).

(iv) *Expense factor.* The affected expenses factor is 0.0833, which represents the ratio of

the gross amount of affected expenses paid by Trust for the calendar year (\$45x) to the total amount of NMWHFIT distributions for the calendar year (\$540x).

(3) *Step Three: Trustee determines adjustments for reconciling the total amount of NMWHFIT distributions with amounts paid to TIHs.* To enable requesting persons to determine the total amount of NMWHFIT distributions that are attributable to a TIH based on amounts actually paid to the TIH, the trustee must provide both a current year-end cash allocation factor and a prior year cash allocation factor.

(i) *Current year-end cash allocation factor.* The adjustment factor for cash held by Trust at year end is 1.5960, which represents the cash held for distribution as of December 31, 2007 (\$158x) (the amount of cash held by Trust on December 31, 2007 (\$173x) reduced by accrued, but unpaid, expenses (\$15x)), divided by the number of trust interests outstanding at year-end (99).

(ii) *Prior Year Cash Allocation Factor.* The adjustment factor for distributions of year-end cash from the prior year is 0.1200, which represents the amount of the distribution during the current calendar year that was included in a year-end cash allocation factor for a prior year (\$12x), divided by the number of trust interests outstanding at the time of the distribution (100). The prior year cash distribution date is April 15, 2007.

(4) *Reporting sales and dispositions of trust assets—(i) Application of the de minimis test.* The aggregate fair market value of the assets of Trust as of January 1, 2007, was \$10,000x. During the 2007 calendar year, Trust received trust sales proceeds of \$1115x. The trust sales proceeds received by Trust for the 2007 calendar year equal 11.15% of Trust's fair market value as of January 1, 2007. Accordingly, the *de minimis* test is not satisfied for the 2007 calendar year. The qualified NMWHFIT exception in paragraph (c)(2)(iv)(E) of this section and the NMWHFIT final calendar year exception in (c)(2)(iv)(F) of this section also do not apply to Trust for the 2007 calendar year.

(ii) *Information to be provided.* To satisfy the requirements of paragraph (f)(1) of this section with respect to sales and dispositions of Trust's assets, Trustee provides a list of dates on which trust assets were sold during the calendar year, and provides, for each date: the trust sales proceeds (per trust interest) received on that date; the trust sales proceeds distributed to TIHs (per trust interest) with respect to sales or dispositions on that date; the date those trust sales proceeds were distributed, and the ratio of the assets sold or disposed of on that day to all the assets held by Trust. Because Trust will terminate within 15 months of its start-up date, Trustee must use the fair market value of

**Internal Revenue Service, Treasury**

**§ 1.671-5**

the assets as of the start-up date to determine the portion of Trust sold or disposed of on any particular date.

(5) *Reporting redemptions.* Because Trust is not required to make distributions at least as frequently as monthly, and Trust does not satisfy the qualified NMWHFIT exception in paragraph (c)(2)(iv)(E) of this section, the exception in paragraph (c)(2)(v)(C) does not apply to Trust. To satisfy the requirements of paragraph (f)(1) of this section, Trustee provides a list of dates for which the redemption proceeds to be paid for the redemption of a trust interest was determined for the 2007 calendar year and the redemptions asset proceeds paid for each date. During 2007, Trustee only determined the amount of redemption proceeds paid for the redemption of a trust interest once, for December 10, 2007 and the redemption asset proceeds determined for that date was \$115x.

(6) *Reporting sales of trust interests.* Because trust is not required to make distributions at least as frequently as monthly, and Trust does not satisfy the qualified NMWHFIT ex-

ception in paragraph (c)(2)(iv)(E) of this section, the exception in paragraph (c)(2)(v)(C) of this section does not apply to Trust. Sponsor, in accordance with the trust agreement, provides Trustee with a list of dates on which sales on the secondary market occurred. To satisfy the requirements of paragraph (f)(1) of this section, Trustee provides requesting persons with a list of dates on which sales on the secondary market occurred and the amount of cash held for distribution, per trust interest, on each date. The first sale during the 2007 calendar year occurred on September 30, 2007, and the amount of cash held for distribution, per trust interest, on that date is \$1.35x. The second sale occurred on December 10, 2007, and the amount of cash held for distribution, per trust interest, on that date is \$1.00x.

(iii) *Brokers' use of information provided by Trustee.* (A) Broker1 and Broker2 use the information furnished by Trustee under the safe harbor to determine that the following items are attributable to J, A, and S—

With respect to J		
Ordinary Dividend Income .....		\$17.89x
Qualified Dividend Income .....		38.07x
Interest Income .....		1.14x
Affected Expenses .....		4.28x
Trust sales proceeds reported on Form 1099 .....		108.13x
Redemption asset proceeds		
For redemption on December 10 .....		115.00x
Sale asset proceeds		
For sale on September 30 .....		114.00x
For sale on December 10 .....		115.00x
With respect to A		
Ordinary Dividend Income .....		18.82x
Qualified Dividend Income .....		40.04x
Interest Income .....		1.20x
Affected Expenses .....		4.50x
Trust sales proceeds reported on Form 1099 .....		11.62x
With respect to S		
Ordinary Dividend Income .....		19.54x
Qualified Dividend Income .....		41.58x
Interest Income .....		1.25x
Affected Expenses .....		4.68x
Trust sales proceeds reported on Form 1099 .....		113.94x

With respect to J, A, and S (regarding the sales and dispositions executed by Trust during the calendar year)

Date	Trust sales proceeds received per trust interest	Percent of trust sold
June 15 .....	\$10.0000x .....	20
December 12 .....	1.1616x .....	2

(B) The brokers determine the information provided to J, A, and S as follows—

(1) *Step One: Brokers determine the total amount of NMWHFIT distributions attributable to J, A, and S.* Broker1 determines that the total amount of NMWHFIT distributions attributable to J is \$51.39x and the total amount of NMWHFIT distributions attrib-

utable to A is \$54.06x. Broker2 determines that the total amount of NMWHFIT distributions attributable to S is \$56.13x.

(i) To calculate these amounts the brokers begin by determining the total amount paid to J, A, and S for the calendar year—

(A) The total amount paid to J for the calendar year equals \$485.42x and includes the April 15, 2007, distribution of \$13.50x, the July 15, 2007, distribution of \$113.50x, the sales proceeds for the September 30, 2007, sale of \$115.35x, the October 15, 2007, distribution of \$11.07x, and the redemption proceeds of \$116x and sales proceeds of \$116x for the redemption and sale on December 10, 2007.

(B) The total amount paid to A for the calendar year equals \$139.30x and includes the April 15, 2007, distribution of \$13.50x, the July

15, 2007, distribution of \$113.50x and the October 15, 2007, distribution of \$12.30x.

(C) The total amount paid to *S* for the calendar year equals \$140.53x and includes the April 15, 2007, distribution of \$13.50x, the July 15, 2007, distribution of \$113.50x and the October 15, 2007, distribution of \$13.53x.

(ii) The brokers increase the total amount paid to *J*, *A*, and *S* by an amount equal to the current year-end cash allocation factor (1.5960) multiplied by the number of trust interests held by *J* (7), *A* (10), and *S* (12) as of December 31, 2007; that is for *J*, \$11.17x; for *A*, \$15.96x; and for *S*, \$19.15x.

(iii) The brokers reduce the amount paid to *J*, *A*, and *S* as follows—

(A) An amount equal to the prior year cash allocation factor (0.1200), multiplied by the number of trust interests held by *J* (10), *A* (10), and *S* (10) on the date of the prior year cash distribution; that is for *J*, *A*, and *S*, \$1.20x, each;

(B) An amount equal to all redemption asset proceeds paid to a TIH for the calendar year; that is, for *J*, \$115x;

(C) An amount equal to all sales asset proceeds attributable to the TIH for the calendar year; that is for *J*, \$229x (for the September 30, 2007, sale: \$115.35x-1.35x (cash held for distribution per trust interest on that date)-\$114x; and for the December 10, 2007, sale: \$116x-1.00 (cash held for distribution per trust interest on that date)=\$115x);

(D) In the case of a purchasing TIH, an amount equal to the amount of cash held for distribution per trust interest at the time the TIH purchased its trust interest, multiplied by the number of trust interests purchased; that is for *S*, \$2.35x (\$1.35x with respect to the September 30, 2007, sale and \$1x with respect to the December 10, 2007, sale);

(E) All amounts of trust sales proceeds distributed to the TIH for the calendar year; that is for *J*, *A*, and *S*, \$100. (\$100 each, with respect to the June 15, 2007, sale of assets by Trust, and \$0 each, with respect to the December 12, 2007, sale of assets by Trust).

(2) *Step two: The brokers apply the factors provided by Trustee to determine the Trust's income and expenses that are attributable to J, A, and S.* The amounts of each item of income (other than OID) and expense that are attributable to *J*, *A*, and *S* are determined by multiplying the factor for that type of income or expense by the total amount of NMWHFIT distributions attributable to *J*, *A*, and *S* as follows:

(i) *Application of factor for ordinary dividends.* The amount of ordinary dividend income attributable to *J* is \$17.89x, to *A* is \$18.82x, and to *S* is \$19.54x. The brokers determine these amounts by multiplying the total amount of NMWHFIT distributions attributable to *J*, *A*, and *S* (\$51.39x, \$54.06x, and \$56.13x, respectively) by the factor for ordinary dividends (0.3481).

(ii) *Application of factor for qualified dividend income.* The amount of qualified dividend income attributable to *J* is \$38.07x, to *A* is \$40.04x, and to *S* is \$41.58x. The brokers determine these amounts by multiplying the total amount of NMWHFIT distributions attributable to *J*, *A*, and *S* (\$51.39x, \$54.06x, and \$56.13x, respectively) by the factor for qualified dividends (0.7407).

(iii) *Application of factor for interest income.* The amount of interest income attributable to *J* is \$1.14x, to *A* is \$1.20x, and to *S* is \$1.25x. The brokers determine these amounts by multiplying the total amount of NMWHFIT distributions attributable to *J*, *A*, and *S* (\$51.39x, \$54.06x, and \$56.13x, respectively) by the factor for interest (0.0222).

(iv) *Application of factor for affected expenses.* The amount of affected expenses attributable to *J* is \$4.28x, to *A* is \$4.50x, and to *S* is \$4.68x. The brokers determine these amounts by multiplying the total amount of NMWHFIT distributions attributable to *J*, *A*, and *S* (\$51.39x, \$54.06x, and \$56.13x, respectively) by the factor for affected expenses (0.0833).

(3) *Brokers reporting of sales and dispositions of trust assets—(i) Determining the amount of trust sales proceeds to be reported on Form 1099 for J, A, and S.* The amount of trust sales proceeds to be reported on Form 1099 with respect to *J* is \$108.13x, to *A* is \$111.62x, and to *S* is \$113.94x. To determine these amounts, the brokers aggregate the amount of trust sales proceeds attributable to *J*, *A*, and *S* for each date on which Trust sold or disposed of assets. The brokers determine the amount of trust sales proceeds to be reported with respect to the June 15, 2007, asset sale by multiplying the number of trust interests held by *J* (10), *A* (10) and *S* (10) on that date by the trust sales proceeds received per trust interest on that date (\$10x). The brokers determine the amount of trust sales proceeds to be reported with respect to the December 12, 2007, asset sale by multiplying the number of trust interests held by *J* (7), *A* (10) and *S* (12) on that date by the trust sales proceeds received per trust interest on that date (\$1.1616x).

(ii) *Information provided on the tax information statements furnished to J, A, and S.* The tax information statements furnished to *J*, *A*, and *S* must include the dates of each sale or disposition (June 15, 2007, and December 12, 2007); the amount of trust sales proceeds per trust interest received on those dates (\$10.00x and \$1.1616x, respectively); and, the percentage of Trust sold or disposed of on that date (20% and 2%, respectively).

(4) *Reporting redemptions.* Broker1 reports on Form 1099 and on the written tax information statement furnished to *J* that *J* received \$115x in redemption asset proceeds for the calendar year.

(5) *Reporting sales of trust interests on the secondary market.* Broker1 reports on *J*'s two

sales of trust interests. With respect to the sale on September 30, 2007, the sale asset proceeds equals \$114x (\$115.35x sale proceeds—\$1.35x cash held for distribution on that date) and with respect to the sale on December 10, 2007, the sale asset proceeds equal \$115x (\$116x sale proceeds—\$1x cash held for distribution on that date). Broker1 reports these amounts on Form 1099 and on the tax information statement furnished to J.

(g) *Safe Harbor for certain WHMTs*—(1) *Safe harbor for trustee of certain WHMTs for reporting information*—(i) *In general.* The trustee of a WHMT that meets the requirements of paragraph (g)(1)(ii) of this section is deemed to satisfy paragraph (c)(1)(i) of this section, if the trustee calculates and provides WHFIT information in the manner described in this paragraph (g) and provides a statement to the requesting person giving notice that information has been calculated in accordance with this paragraph (g)(1).

(ii) *Requirements.* A WHMT must meet the following requirements—

(A) The WHMT must make monthly distributions of the income and principal payments received by the WHMT to its TIHs;

(B) All trust interests in the WHMT must represent the right to receive an equal pro-rata share of both the income and the principal payments received by the WHMT on the mortgages it holds (for example, a WHMT that holds or issues trust interests that qualify as stripped interests under section 1286 may not report under this safe harbor);

(C) The WHMT must—

(1) Report under this paragraph (g)(1)(ii) for the life of the WHMT; or

(2) If the WHMT has a start-up date before January 1, 2007, the WHMT must begin reporting under this paragraph (g)(1)(ii) as of January 1, 2007, and must continue to report under this paragraph for the life of the WHMT;

(D) The WHMT must calculate all items subject to the safe harbor consistent with the safe harbor;

(E) The assets of the WHMT must be limited to—

(1) Mortgages with uniform characteristics;

(2) Reasonably required reserve funds; and

(3) Amounts received on mortgages or reserve funds and held for distribution to TIHs; and

(F) The aggregate outstanding principal balance (as defined in paragraph (g)(1)(iii)(D) of this section) as of the WHMT's start-up date must equal the aggregate of the original face amounts of all issued trust interests.

(iii) *Reporting WHMT income, expenses, non pro-rata partial principal payments, and sales and dispositions under the safe harbor.* A trustee must comply with each step provided in this paragraph (g)(1)(iii).

(A) *Step One: Determine monthly pool factors.* The trustee must, for each month of the calendar year and for January of the following calendar year, calculate and provide the ratio (expressed as a decimal carried to at least eight places and called a *pool factor*) of—

(1) The amount of the aggregate outstanding principal balance of the WHMT as of the first business day of the month; to

(2) The amount of the aggregate outstanding principal balance of the WHMT as of the start-up date.

(B) *Step Two: Determine monthly expense factors.* For each month of the calendar year and for each item of expense paid by the WHMT during that month, the trustee must calculate and provide the ratio (expressed as a decimal carried to at least eight places and called an *expense factor*) of—

(1) The gross amount, for the month, of each item of expense; to

(2) The amount that represents the aggregate outstanding principal balance of the WHMT as of the start-up date, divided by 1,000.

(C) *Step Three: Determine monthly income factors.* For each month of the calendar year and for each item of gross income earned by the WHMT during that month, the trustee must calculate and provide the ratio (expressed as a decimal carried to at least eight places and called an *income factor*) of—

(1) The gross amount, for the month, of each item of income, to

(2) The amount that represents the aggregate outstanding principal balance of the WHMT as of the start-up date, divided by 1,000.

(D) *Definition of aggregate outstanding principal balance.* For purposes of this paragraph (g)(1)(iii), the amount of the

aggregate outstanding principal balance of a WHMT is the aggregate of—

(1) The outstanding principal balance of all mortgages held by the WHMT;

(2) The amounts received on mortgages as principal payments and held for distribution by the WHMT; and

(3) The amount of the reserve fund (exclusive of undistributed income).

(iv) *Reporting OID information under the safe harbor—(A) Reporting OID prior to the issuance of final regulations under section 1272(a)(6)(C)(iii)—(1)* For calendar years prior to the effective date of final regulations under section 1272(a)(6)(C)(iii), the trustee must provide, for each month during the calendar year, the aggregate daily accrual of OID per \$1,000 of aggregate outstanding principal balance as of the start-up date (daily portion). For purposes of this paragraph (g)(1)(iv), the daily portion of OID is determined by allocating to each day of the month its ratable portion of the excess (if any) of—

(i) The sum of the present value (determined under section 1272(a)(6)(B)) of all remaining payments under the mortgages held by the WHMT at the close of the month, and the payments during the month of amounts included in the stated redemption price of the mortgages, over

(ii) The aggregate of each mortgage's adjusted issue price as of the beginning of the month.

(2) In calculating the daily portion of OID, the trustee must use the prepayment assumption used in pricing the original issue of trust interests. If the WHMT has a start-up date prior to January 24, 2006, and the trustee, after a good faith effort to ascertain that information, does not know the prepayment assumption used in pricing the original issue of trust interests, the trustee may use any reasonable prepayment assumption to calculate OID provided it continues to use the same prepayment assumption consistently thereafter.

(B) *Reporting OID after the issuance of final regulations under section 1272(a)(6)(C)(iii)*. [Reserved]

(v) *Reporting market discount information under the safe harbor—(A) Reporting market discount information prior to the issuance of final regulations under sec-*

*tions 1272(a)(6)(C)(iii) and 1276(b)(3)*. For calendar years prior to the effective date of final regulations under sections 1272(a)(6)(C)(iii) and 1276(b)(3), the trustee must provide—

(1) In the case of a WHMT holding mortgages issued with OID, the ratio (expressed as a decimal carried to at least eight places) of—

(i) The OID accrued during the month (calculated in accordance with paragraph (g)(1)(iv) of this section); to

(ii) The total remaining OID as of the beginning of the month (as determined under paragraph (g)(1)(v)(A)(3) of this section); or

(2) In the case of a WHMT holding mortgages issued without OID, the ratio (expressed as a decimal carried to at least eight places) of—

(i) The amount of stated interest paid to the WHMT during the month; to

(ii) The total amount of stated interest remaining to be paid to the WHMT as of the beginning of the month (as determined under paragraph (g)(1)(v)(A)(3) of this section).

(3) *Computing the total amount of stated interest remaining to be paid and the total remaining OID at the beginning of the month*. To compute the total amount of stated interest remaining to be paid to the WHMT as of the beginning of the month and the total remaining OID as of the beginning of the month, the trustee must use the prepayment assumption used in pricing the original issue of trust interests. If the WHMT has a start-up date prior to January 24, 2006, and the trustee, after a good faith effort to ascertain that information, does not know the prepayment assumption used in pricing the original issue of trust interests, the trustee may use any reasonable prepayment assumption to calculate these amounts provided it continues to use the same prepayment assumption consistently thereafter.

(vi) *Reporting bond premium information under the safe harbor*. [Reserved]

(2) *Use of information provided by a trustee under the safe harbor—(i) In general*. If a trustee reports WHMT items in accordance with paragraph (g)(1) of this section, the information provided with respect to those items on the Forms 1099 required to be filed with the IRS under paragraph (d) of this section

and on the statement required to be furnished to the TIH under paragraph (e) of this section must be determined as provided in this paragraph (g)(2).

(ii) *Reporting WHMT income, expenses, non pro-rata partial principal payments, and sales and dispositions under the safe harbor.* The amount of each item of income, the amount of each item of expense, and the combined amount of non pro-rata partial principal payments and trust sales proceeds that are attributable to a TIH for each month of the calendar year must be computed as follows:

(A) *Step One: Determine the aggregate of the non pro-rata partial principal payments and trust sales proceeds that are attributable to the TIH for the calendar year.* For each month of the calendar year that a trust interest was held on the record date—

(1) *Determine the monthly amounts per trust interest.* The trustee or middleman must determine the aggregate amount of non pro-rata partial principal payments and the trust sales proceeds that are attributable to each trust interest for each month by multiplying—

(i) The original face amount of the trust interest; by

(ii) The difference between the pool factor for the current month and the pool factor for the following month.

(2) *Determine the amount for the calendar year.* The trustee or middleman must multiply the monthly amount per trust interest by the number of trust interests held by the TIH on the record date of each month. The trustee or middleman then must aggregate these monthly amounts, and report the aggregate amount on the Form 1099 filed with the IRS and on the tax information statement furnished to the TIH as trust sales proceeds. No other information is required to be reported to the IRS or the TIH to satisfy the requirements of paragraphs (d) and (e) of this section under this paragraph (g) with respect to sales and dispositions and non pro-rata partial principal payments.

(B) *Step Two: Determine the amount of each item of expense that is attributable to a TIH—*(1) *Determine the monthly amounts per trust interest.* For each month of the calendar year that a trust interest was held on the record date,

the trustee or middleman must determine the amount of each item of expense that is attributable to each trust interest by multiplying—

(i) The original face amount of the trust interest, divided by 1000; by

(ii) The expense factor for that month and that item of expense.

(2) *Determine the amount for the calendar year.* The trustee or middleman must multiply the monthly amount of each item of expense per trust interest by the number of trust interests held by the TIH on the record date of each month. The trustee or middleman then must aggregate the monthly amounts for each item of expense to determine the total amount of each item of expense that is attributable to the TIH for the calendar year.

(C) *Step Three: Determine the amount of each item of income that is attributable to the TIH for the calendar year—*(1) *Determine the monthly amounts per trust interest.* For each month of the calendar year that a trust interest was held on the record date, the trustee or middleman must determine the amount of each item of income that is attributable to each trust interest by multiplying—

(i) The original face amount of the trust interest, divided by 1,000; by

(ii) The income factor for that month and that item of income.

(2) *Determine the amount for the calendar year.* The trustee or middleman must multiply the monthly amount of each item of income per trust interest by the number of trust interests held by the TIH on the record date of each month. The trustee or middleman then must aggregate the monthly amounts for each item of income to determine the total amount of each item of income that is attributable to the TIH for the calendar year.

(D) *Definitions for this paragraph (g)(2).* For purposes of this paragraph (g)(2)(ii)—

(1) *The record date* is the date used by the WHMT to determine the owner of the trust interest for the purpose of distributing the payment for the month.

(2) *The original face amount of the trust interest* is the original principal amount of a trust interest on its issue date.

(iii) *Reporting OID information under the safe harbor.* With respect to each month, trustee or middleman must determine the amount of OID that is attributable to each trust interest held by a TIH by multiplying—

(A) The product of the OID factor multiplied by the original face amount of the trust interest, divided by 1,000; by

(B) The number of days during the month that the TIH held the trust interest.

(iv) *Requirement to provide market discount information under the safe harbor.* The trustee or middleman must provide the market discount information in accordance with paragraph (g)(1)(v) of this section to the TIH in, or with, the written statement required to be furnished to the TIH under paragraph (e) of this section.

(v) *Requirement to provide bond premium information under the safe harbor.* [Reserved]

(3) *Example of safe harbor in paragraph (g)(1) of this section.* The following example illustrates the use of the factors in this paragraph (g) to calculate and provide WHMT information:

*Example.* (i) *Facts—*(A) *In general.* X is a WHMT. X's start-up date is January 1, 2007. As of that date, X's assets consist of 100 15-year mortgages, each having an unpaid principal balance of \$125,000 and a fixed, annual interest rate of 7.25 percent. None of the mortgages were issued with OID. X's TIHs are entitled to monthly, pro-rata distributions of the principal payments received by X. X's TIHs are also entitled to monthly, pro-rata distributions of the interest earned on the mortgages held by X, reduced by expenses. Trust interests are issued in increments of \$5,000 with a \$25,000 minimum. The prepayment assumption used in pricing the original issue of trust interests is six percent. Broker holds a trust interest in X, with an original face amount of \$25,000, in street name, for C during the entire 2007 calendar year.

(B) *Trust events during the 2007 calendar year.* During the 2007 calendar year, X collects all interest and principal payments when due and makes all monthly distributions when due. One mortgage is repurchased from X in July 2007 for \$122,249, the mortgage's unpaid principal balance plus accrued, but unpaid, interest at the time. During November 2007, another mortgage is prepaid in full. X earns \$80 interest income each month from the temporary investment of X's funds pending distribution to the TIHs. All of X's

expenses are affected expenses. The aggregate outstanding principal balance of X's mortgages, X's interest income, and X's expenses, for each month of the 2007 calendar year, along with the aggregate outstanding principal balance of X as of January 2008, are as follows:

Month	Principal balance	Income	Expenses
January .....	\$12,500,000	\$75,601	\$5,288
February .....	12,461,413	75,368	5,273
March .....	12,422,593	75,133	5,256
April .....	12,383,538	74,897	5,240
May .....	12,344,247	74,660	5,244
June .....	12,304,719	74,421	5,207
July .....	12,264,952	74,181	5,191
August .....	12,102,696	73,200	5,122
September .....	12,062,849	72,960	5,106
October .....	12,022,762	72,718	5,089
November .....	11,982,432	72,474	5,073
December .....	11,821,234	71,500	5,006
January .....	11,780,829	.....	.....

(ii) *Trustee reporting.* (A) Trustee, X's fiduciary, comes within the safe harbor of paragraph (g)(1)(ii) of this section by providing the following information to requesting persons:

Month	Pool factor	Income factor	Expense factor
January .....	1.00000000	6.04806667	0.42304000
February .....	0.99691304	6.02941628	0.42184000
March .....	0.99380744	6.01065328	0.42048000
April .....	0.99068304	5.99177670	0.41920000
May .....	0.98753976	5.97278605	0.41952000
June .....	0.98437752	5.95368085	0.41656000
July .....	0.98119616	5.93446013	0.41528000
August .....	0.96821564	5.85603618	0.40976000
September .....	0.96502792	5.83677704	0.40848000
October .....	0.96182096	5.81740161	0.40712000
November .....	0.95859459	5.79790896	0.40584000
December .....	0.94569875	5.71999659	0.40048000
January .....	0.94246631	.....	.....

(B) Trustee determines this information as follows:

(1) *Step One: Trustee determines monthly pool factors.* Trustee calculates and provides X's pool factor for each month of the 2007 calendar year. For example, for the month of January 2007 the pool factor is 1.0, which represents the ratio of—

(i) The amount that represents the aggregate outstanding principal balance of X (\$12,500,000) as of the first business day of January; divided by

(ii) The amount that represents the aggregate outstanding principal balance of X (\$12,500,000) as of the start-up day.

(2) *Step Two: Trustee determines monthly expense factors.* Trustee calculates and provides the expense factors for each month of the 2007 calendar year. During 2007, X has only affected expenses, and therefore, will have only one expense factor for each month. For example, the expense factor for the month of January 2007 is 0.42304000, which represents the ratio of—

(i) The gross amount of expenses paid during January by X (\$5,288); divided by

(ii) The amount that represents the aggregate outstanding principal balance of X as of the start-up date (\$12,500,000) divided by 1,000 (\$12,500).

(3) *Step Three: Trustee determines monthly income factors.* Trustee calculates and provides the income factors for each month of the 2007 calendar year. During 2007, X has only interest income, and therefore, will have only one income factor for each month. For example, the income factor for the month of January 2007 is 6.04806667, which represents the ratio of—

(i) The gross amount of interest income earned by X during January (\$75,601); divided by

(ii) The amount that represents that aggregate outstanding principal balance of X as of the start-up date (\$12,500,000), divided by 1,000 (\$12,500).

(4) *Step Four: Trustee calculates and provides monthly market discount fractions.* Trustee calculates and provides a market discount fraction for each month of the 2007 calendar year using a prepayment assumption of 6% and a stated interest rate of 7.25%.

(iii) *Broker's use of the information provided by Trustee.* (A) Broker uses the information provided by Trustee under paragraph (g) of this section to determine that the following trust items are attributable to C:

Month	Aggregate trust sales proceeds and non pro-rata partial principal payments	Affected expenses	Gross interest income
January .....	\$77.17	\$10.58	\$151.20
February .....	77.64	10.55	150.74
March .....	78.11	10.51	150.27
April .....	78.58	10.48	149.79
May .....	79.06	10.49	149.32
June .....	79.53	10.41	148.84
July .....	324.51	10.38	148.36
August .....	79.69	10.24	146.40
September .....	80.17	10.21	145.92
October .....	80.66	10.18	145.43
November .....	322.40	10.15	144.95
December .....	80.81	10.01	143.00
Total .....	1438.33	124.19	1774.22

(B) Broker determines this information as follows:

(1) *Step One: Broker determines the amount of the non pro-rata partial principal payments and trust sales proceeds received by X that are attributable to C for the 2007 calendar year.* Broker determines the amount of the non pro-rata partial principal payments and trust sales proceeds received by X that are attributable to C for each month of the 2007 calendar year. For example, for the month of January, Broker determines that the amount of principal receipts and the amount of trust sales proceeds that are attributable to C is \$77.17. Broker determines this by mul-

tiplying the original face amount of C's trust interest (\$25,000) by 0.00308696, the difference between the pool factor for January 2007 (1.00000000) and the pool factor for the following month of February 2007 (0.99691304). Broker reports the aggregate of the monthly amounts of non pro-rata partial principal payments and trust sales proceeds that are attributable to C for the 2007 calendar year as trust sales proceeds on the Form 1099 filed with the IRS.

(2) *Step Two: Broker applies the expense factors provided by Trustee to determine the amount of expenses that are attributable to C for the 2007 calendar year.* Broker determines the amount of X's expenses that are attributable to C for each month of the calendar year. For example, for the month of January 2007, Broker determines that the amount of expenses attributable to C is \$10.58. Broker determines this by multiplying the original face amount of C's trust interest (\$25,000), divided by 1,000 (\$25) by the expense factor for January 2007 (0.42304000). Broker determines the expenses that are attributable to C for the 2007 calendar year by aggregating the monthly amounts.

(3) *Step Three: Broker applies the income factors provided by Trustee to determine the amount of gross interest income attributable to C for the 2007 calendar year.* Broker determines the amount of gross interest income that is attributable to C for each month of the calendar year. For example, for the month of January 2007, Broker determines that the amount of gross interest income attributable to C is \$151.20. Broker determines this by multiplying the original face amount of C's trust interest (\$25,000), divided by 1,000 (\$25), by the income factor for January 2007 (6.04806667). Broker determines the amount of the gross interest income that is attributable to C for the 2007 calendar year by aggregating the monthly amounts.

(4) *Step Four: Broker provides market discount information to C.* Broker provides C with the market discount fractions calculated and provided by the trustee of X under paragraph (g)(3)(ii)(D) of this section.

(h) *Additional safe harbors—(1) Temporary safe harbor for WHMTs—(i) Application.* Pending the issuance of additional guidance, the safe harbor in this paragraph applies to trustees and middlemen of WHMTs that are not eligible to report under the WHMT safe harbor in paragraph (g) of this section because they hold interests in another WHFIT, in a REMIC, or hold or issue stripped interests.

(ii) *Safe harbor.* A trustee is deemed to satisfy the requirements of paragraph (c) of this section, if the trustee

calculates and provides trust information in a manner that enables a requesting person to provide trust information to a beneficial owner of a trust interest that enables the owner to reasonably accurately report the tax consequences of its ownership of a trust interest on its federal income tax return. Additionally, to be deemed to satisfy the requirements of paragraph (c) of this section, the trustee must calculate and provide trust information regarding market discount and OID by any reasonable manner consistent with section 1272(a)(6). A middleman or a trustee may satisfy its obligation to furnish information to the IRS under paragraph (d) of this section and to the trust interest holder under paragraph (e) of this section by providing information consistent with the information provided under this paragraph by the trustee.

(2) *Additional safe harbors provided by other published guidance.* The IRS and the Treasury Department may provide additional safe harbor reporting procedures for complying with this section or a specific paragraph of this section by other published guidance (see § 601.601(d)(2) of this chapter).

(i) [Reserved]

(j) *Requirement that middlemen furnish information to beneficial owners that are exempt recipients and noncalendar-year beneficial owners—(1) In general.* A middleman that holds a trust interest on behalf of, or for the account of, either a beneficial owner that is an exempt recipient defined in paragraph (b)(7) of this section or a noncalendar-year beneficial owner, must provide to such beneficial owner, upon request, the information provided by the trustee to the middleman under paragraph (c) of this section.

(2) *Time for providing information.* The middleman must provide the requested information to any beneficial owner making a request under paragraph (h)(1) of this section on or before the later of the 44th day after the close of the calendar year for which the information was requested, or the day that is 28 days after the receipt of the request. A middleman must provide information with respect to a WHFIT holding an interest in another WHFIT, or a WHFIT holding an interest in a

REMIC, on or before the later of the 58th day after the close of the calendar year for which the information was requested, or the 42nd day after the receipt of the request.

(3) *Manner of providing information.* The requested information must be provided—

(i) By written statement sent by first class mail to the address provided by the person requesting the information;

(ii) By electronic mail provided that the person requesting the information requests that the middleman furnish the information by electronic mail and the person furnishes an electronic address;

(iii) At an Internet website of the middleman or the trustee, provided that the beneficial owner requesting the information is notified that the requested information is available at the Internet website and is furnished the address of the site; or

(iv) Any other manner agreed to by the middleman and the beneficial owner requesting the information.

(4) *Clearing organization.* A clearing organization described in § 1.163-5(c)(2)(i)(D)(8) is not required to furnish information to exempt recipients or non-calendar-year TIHs under this paragraph (h).

(k) *Coordination with other information reporting rules.* In general, in cases in which reporting is required for a WHFIT under both this section and subpart B, part III, subchapter A, chapter 61 of the Internal Revenue Code (Sections 6041 through 6050S) (Information Reporting Sections), the reporting rules for WHFITs under this section must be applied. The provisions of the Information Reporting Sections and the regulations thereunder are incorporated into this section as applicable, but only to the extent that such provisions are not inconsistent with the provisions of this section.

(l) *Backup withholding requirements.* Every trustee and middleman required to file a Form 1099 under this section is a payor within the meaning of § 31.3406(a)-2, and must backup withhold as required under section 3406 and any regulations thereunder.

(m) *Penalties for failure to comply—(1) In general.* Every trustee or middleman who fails to comply with the reporting

obligations imposed by this section is subject to penalties under sections 6721, 6722, and any other applicable penalty provisions.

(2) *Penalties not imposed on trustees and middlemen of certain WHMTs for failure to report OID.* Penalties will not be imposed as a result of a failure to provide OID information for a WHMT that has a start-up date on or after August 13, 1998 and on or before January 24, 2006, if the trustee of the WHMT does not have the historic information necessary to provide this information and the trustee demonstrates that it has attempted in good faith, but without success, to obtain this information. For purposes of calculating a market discount fraction under paragraph (g)(1)(v) of this section, for a WHMT described in this paragraph, it may be assumed that the WHMT is holding mortgages that were issued without OID. A trustee availing itself of this paragraph must include a statement to that effect when providing information to requesting persons under paragraph (c) of these regulations.

(n) *Effective date.* These regulations are applicable January 1, 2007. Trustees must calculate and provide trust information with respect to the 2007 calendar year and all subsequent years consistent with these regulations. Information returns required to be filed with the IRS and the tax information statements required to be furnished to trust interest holders after December 31, 2007 must be consistent with these regulations.

[T.D. 9241, 71 FR 4009, Jan. 24, 2006, as amended by T.D. 9279, 71 FR 43971, Aug. 3, 2006; T.D. 9308, 71 FR 78356, Dec. 29, 2006]

**§ 1.672(a)-1 Definition of adverse party.**

(a) Under section 672(a) an adverse party is defined as any person having a substantial beneficial interest in a trust which would be adversely affected by the exercise or nonexercise of a power which he possesses respecting the trust. A trustee is not an adverse party merely because of his interest as trustee. A person having a general power of appointment over the trust property is deemed to have a beneficial interest in the trust. An interest is a substantial interest if its value in rela-

tion to the total value of the property subject to the power is not insignificant.

(b) Ordinarily, a beneficiary will be an adverse party, but if his right to share in the income or corpus of a trust is limited to only a part, he may be an adverse party only as to that part. Thus, if A, B, C, and D are equal income beneficiaries of a trust and the grantor can revoke with A's consent, the grantor is treated as the owner of a portion which represents three-fourths of the trust; and items of income, deduction, and credit attributable to that portion are included in determining the tax of the grantor.

(c) The interest of an ordinary income beneficiary of a trust may or may not be adverse with respect to the exercise of a power over corpus. Thus, if the income of a trust is payable to A for life, with a power (which is not a general power of appointment) in A to appoint the corpus to the grantor either during his life or by will, A's interest is adverse to the return of the corpus to the grantor during A's life, but is not adverse to a return of the corpus after A's death. In other words, A's interest is adverse as to ordinary income but is not adverse as to income allocable to corpus. Therefore, assuming no other relevant facts exist, the grantor would not be taxable on the ordinary income of the trust under section 674, 676, or 677, but would be taxable under section 677 on income allocable to corpus (such as capital gains), since it may in the discretion of a nonadverse party be accumulated for future distribution to the grantor. Similarly, the interest of a contingent income beneficiary is adverse to a return of corpus to the grantor before the termination of his interest but not to a return of corpus after the termination of his interest.

(d) The interest of a remainderman is adverse to the exercise of any power over the corpus of a trust, but not to the exercise of a power over any income interest preceding his remainder. For example, if the grantor creates a trust which provides for income to be distributed to A for 10 years and then for the corpus to go to X if he is then living, a power exercisable by X to revest corpus in the grantor is a power

### § 1.672(b)-1

### 26 CFR Ch. I (4-1-12 Edition)

exercisable by an adverse party; however, a power exercisable by X to distribute part or all of the ordinary income to the grantor may be a power exercisable by a nonadverse party (which would cause the ordinary income to be taxed to the grantor).

#### § 1.672(b)-1 Nonadverse party.

A *nonadverse party* is any person who is not an adverse party.

#### § 1.672(c)-1 Related or subordinate party.

Section 672(c) defines the term “related or subordinate party”. The term, as used in sections 674(c) and 675(3), means any nonadverse party who is the grantor’s spouse if living with the grantor; the grantor’s father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; or a subordinate employee of a corporation in which the grantor is an executive. For purposes of sections 674(c) and 675(3), these persons are presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on them unless shown not to be subservient by a preponderance of the evidence.

#### § 1.672(d)-1 Power subject to condition precedent.

Section 672(d) provides that a person is considered to have a power described in subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Code, even though the exercise of the power is subject to a precedent giving of notice or takes effect only after the expiration of a certain period of time. However, although a person may be considered to have such a power, the grantor will nevertheless not be treated as an owner by reason of the power if its exercise can only affect beneficial enjoyment of income received after the expiration of a period of time such that, if the power were a reversionary interest, he would not be treated as an owner under section 673. See sections 674(b)(2), 676(b), and the last sentence of section 677(a). Thus, for example, if a grantor creates a

trust for the benefit of his son and retains a power to revoke which takes effect only after the expiration of 2 years from the date of exercise, he is treated as an owner from the inception of the trust. However, if the grantor retains a power to revoke, exercisable at any time, which can only affect the beneficial enjoyment of the ordinary income of a trust received after the expiration of 10 years commencing with the date of the transfer in trust, or after the death of the income beneficiary, the power does not cause him to be treated as an owner with respect to ordinary income during the first 10 years of the trust or during the income beneficiary’s life, as the case may be. See section 676(b).

#### § 1.672(f)-1 Foreign persons not treated as owners.

(a) *General rule*—(1) *Application of the general rule.* Section 672(f)(1) provides that subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code (the grantor trust rules) shall apply only to the extent such application results in an amount (if any) being currently taken into account (directly or through one or more entities) in computing the income of a citizen or resident of the United States or a domestic corporation. Accordingly, the grantor trust rules apply to the extent that any portion of the trust, upon application of the grantor trust rules without regard to section 672(f), is treated as owned by a United States citizen or resident or domestic corporation. The grantor trust rules do not apply to any portion of the trust to the extent that, upon application of the grantor trust rules without regard to section 672(f), that portion is treated as owned by a person other than a United States citizen or resident or domestic corporation, unless the person is described in § 1.672(f)-2(a) (relating to certain foreign corporations treated as domestic corporations), or one of the exceptions set forth in § 1.672(f)-3 is met, (relating to: trusts where the grantor can revest trust assets; trusts where the only amounts distributable are to the grantor or the grantor’s spouse; and compensatory trusts). Section 672(f) applies to domestic and foreign trusts. Any portion of the trust that is not treated as

## Internal Revenue Service, Treasury

## § 1.672(f)-2

owned by a grantor or another person is subject to the rules of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code.

(2) *Determination of portion based on application of the grantor trust rules.* The determination of the portion of a trust treated as owned by the grantor or other person is to be made based on the terms of the trust and the application of the grantor trust rules and section 671 and the regulations thereunder.

(b) *Example.* The following example illustrates the rules of this section:

*Example.* (i) A, a nonresident alien, funds an irrevocable domestic trust, DT, for the benefit of his son, B, who is a United States citizen, with stock of Corporation X. A's brother, C, who also is a United States citizen, contributes stock of Corporation Y to the trust for the benefit of B. A has a reversionary interest within the meaning of section 673 in the X stock that would cause A to be treated as the owner of the X stock upon application of the grantor trust rules without regard to section 672(f). C has a reversionary interest within the meaning of section 673 in the Y stock that would cause C to be treated as the owner of the Y stock upon application of the grantor trust rules without regard to section 672(f). The trustee has discretion to accumulate or currently distribute income of DT to B.

(ii) Because A is a nonresident alien, application of the grantor trust rules without regard to section 672(f) would not result in the portion of the trust consisting of the X stock being treated as owned by a United States citizen or resident. None of the exceptions in §1.672(f)-3 applies because A cannot revest the X stock in A, amounts may be distributed during A's lifetime to B, who is neither a grantor nor a spouse of a grantor, and the trust is not a compensatory trust. Therefore, pursuant to paragraph (a)(1) of this section, A is not treated as an owner under subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code, of the portion of the trust consisting of the X stock. Any distributions from such portion of the trust are subject to the rules of subparts A through D (641 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code.

(iii) Because C is a United States citizen, paragraph (a)(1) of this section does not prevent C from being treated under section 673 as the owner of the portion of the trust consisting of the Y stock.

(c) *Effective date.* The rules of this section are applicable to taxable years

of a trust beginning after August 10, 1999.

[T.D. 8831, 64 FR 43275, Aug. 10, 1999]

### § 1.672(f)-2 Certain foreign corporations.

(a) *Application of general rule.* Subject to the provisions of paragraph (b) of this section, if the owner of any portion of a trust upon application of the grantor trust rules without regard to section 672(f) is a controlled foreign corporation (as defined in section 957), a passive foreign investment company (as defined in section 1297), or a foreign personal holding company (as defined in section 552), the corporation will be treated as a domestic corporation for purposes of applying the rules of §1.672(f)-1.

(b) *Gratuitous transfers to United States persons—(1) Transfer from trust to which corporation made a gratuitous transfer.* If a trust (or portion of a trust) to which a controlled foreign corporation, passive foreign investment company, or foreign personal holding company has made a gratuitous transfer (within the meaning of §1.671-2(e)(2)), makes a gratuitous transfer to a United States person, the controlled foreign corporation, passive foreign investment company, or foreign personal holding company, as the case may be, is treated as a foreign corporation for purposes of §1.672(f)-4(c), relating to gratuitous transfers from trusts (or portions of trusts) to which a partnership or foreign corporation has made a gratuitous transfer.

(2) *Transfer from trust over which corporation has a section 678 power.* If a trust (or portion of a trust) that a controlled foreign corporation, passive foreign investment company, or foreign personal holding company is treated as owning under section 678 makes a gratuitous transfer to a United States person, the controlled foreign corporation, passive foreign investment company, or foreign personal holding company, as the case may be, is treated as a foreign corporation that had made a gratuitous transfer to the trust (or portion of a trust) and the rules of §1.672(f)-4(c) apply.

(c) *Special rules for passive foreign investment companies—(1) Application of*

### § 1.672(f)-3

### 26 CFR Ch. I (4-1-12 Edition)

*section 1297.* For purposes of determining whether a foreign corporation is a passive foreign investment company as defined in section 1297, the grantor trust rules apply as if section 672(f) had not come into effect.

(2) *References to renumbered Internal Revenue Code section.* For taxable years of shareholders beginning on or before December 31, 1997, and taxable years of passive foreign investment companies ending with or within such taxable years of the shareholders, all references in this § 1.672(f)-2 to section 1297 are deemed to be references to section 1296.

(d) *Examples.* The following examples illustrate the rules of this section. In each example, FT is an irrevocable foreign trust, and CFC is a controlled foreign corporation. The examples are as follows:

*Example 1. Application of general rule.* CFC creates and funds FT. CFC is the grantor of FT within the meaning of § 1.671-2(e). CFC has a reversionary interest in FT within the meaning of section 673 that would cause CFC to be treated as the owner of FT upon application of the grantor trust rules without regard to section 672(f). Under paragraph (a) of this section, CFC is treated as a domestic corporation for purposes of applying the general rule of § 1.672(f)-1. Thus, § 1.672(f)-1 does not prevent CFC from being treated as the owner of FT under section 673.

*Example 2. Distribution from trust to which CFC made gratuitous transfer.* A, a non-resident alien, owns 40 percent of the stock of CFC. A's brother B, a resident alien, owns the other 60 percent of the stock of CFC. CFC makes a gratuitous transfer to FT. FT makes a gratuitous transfer to A's daughter, C, who is a resident alien. Under paragraph (b)(1) of this section, CFC will be treated as a foreign corporation for purposes of § 1.672(f)-4(c). For further guidance, see § 1.672(f)-4(g) *Example 2* through *Example 4*.

(e) *Effective date.* The rules of this section are generally applicable to taxable years of shareholders of controlled foreign corporations, passive foreign investment companies, and foreign personal holding companies beginning after August 10, 1999, and taxable years of controlled foreign corporations, passive foreign investment companies, and foreign personal holding companies

ending with or within such taxable years of the shareholders.

[T.D. 8831, 64 FR 43276, Aug. 10, 1999, as amended by T.D. 8890, 65 FR 41334, July 5, 2000]

### § 1.672(f)-3 Exceptions to general rule.

(a) *Certain revocable trusts—(1) In general.* Subject to the provisions of paragraph (a)(2) of this section, the general rule of § 1.672(f)-1 does not apply to any portion of a trust for a taxable year of the trust if the power to revest absolutely in the grantor title to such portion is exercisable solely by the grantor (or, in the event of the grantor's incapacity, by a guardian or other person who has unrestricted authority to exercise such power on the grantor's behalf) without the approval or consent of any other person. If the grantor can exercise such power only with the approval of a related or subordinate party who is subservient to the grantor, such power is treated as exercisable solely by the grantor. For the definition of *grantor*, see § 1.671-2(e). For the definition of *related or subordinate party*, see § 1.672(c)-1. For purposes of this paragraph (a), a related or subordinate party is subservient to the grantor unless the presumption in the last sentence of § 1.672(c)-1 is rebutted by a preponderance of the evidence. A trust (or portion of a trust) that fails to qualify for the exception provided by this paragraph (a) for a particular taxable year of the trust will be subject to the general rule of § 1.672(f)-1 for that taxable year and all subsequent taxable years of the trust.

(2) *183-day rule.* For purposes of paragraph (a)(1) of this section, the grantor is treated as having a power to revest for a taxable year of the trust only if the grantor has such power for a total of 183 or more days during the taxable year of the trust. If the first or last taxable year of the trust (including the year of the grantor's death) is less than 183 days, the grantor is treated as having a power to revest for purposes of paragraph (a)(1) of this section if the grantor has such power for each day of the first or last taxable year, as the case may be.

(3) *Grandfather rule for certain revocable trusts in existence on September 19, 1995.* Subject to the rules of paragraph

(d) of this section (relating to separate accounting for gratuitous transfers to the trust after September 19, 1995), the general rule of §1.672(f)-1 does not apply to any portion of a trust that was treated as owned by the grantor under section 676 on September 19, 1995, as long as the trust would continue to be so treated thereafter. However, the preceding sentence does not apply to any portion of the trust attributable to gratuitous transfers to the trust after September 19, 1995.

(4) *Examples.* The following examples illustrate the rules of this paragraph (a):

*Example 1. Grantor is owner.* FP1, a foreign person, creates and funds a revocable trust, T, for the benefit of FP1's children, who are resident aliens. The trustee is a foreign bank, FB, that is owned and controlled by FP1 and FP2, who is FP1's brother. The power to revoke T and revest absolutely in FP1 title to the trust property is exercisable by FP1, but only with the approval or consent of FB. The trust instrument contains no standard that FB must apply in determining whether to approve or consent to the revocation of T. There are no facts that would suggest that FB is not subservient to FP1. Therefore, the exception in paragraph (a)(1) of this section is applicable.

*Example 2. Death of grantor.* Assume the same facts as in Example 1, except that FP1 dies. After FP1's death, FP2 has the power to withdraw the assets of T, but only with the approval of FB. There are no facts that would suggest that FB is not subservient to FP2. However, the exception in paragraph (a)(1) of this section is no longer applicable, because FP2 is not a grantor of T within the meaning of §1.671-2(e).

*Example 3. Trustee is not related or subordinate party.* Assume the same facts as in Example 1, except that neither FP1 nor any member of FP1's family has any substantial ownership interest or other connection with FB. FP1 can remove and replace FB at any time for any reason. Although FP1 can replace FB with a related or subordinate party if FB refuses to approve or consent to FP1's decision to revest the trust property in himself, FB is not a related or subordinate party. Therefore, the exception in paragraph (a)(1) of this section is not applicable.

*Example 4. Unrelated trustee will consent to revocation.* FP, a foreign person, creates and funds an irrevocable trust, T. The trustee is a foreign bank, FB, that is not a related or subordinate party within the meaning of §1.672(c)-1. FB has the discretion to distribute trust income or corpus to beneficiaries of T, including FP. Even if FB would in fact distribute all the trust prop-

erty to FP if requested to do so by FP, the exception in paragraph (a)(1) of this section is not applicable, because FP does not have the power to revoke T.

(b) *Certain trusts that can distribute only to the grantor or the spouse of the grantor—(1) In general.* The general rule of §1.672(f)-1 does not apply to any trust (or portion of a trust) if at all times during the lifetime of the grantor the only amounts distributable (whether income or corpus) from such trust (or portion thereof) are amounts distributable to the grantor or the spouse of the grantor. For purposes of this paragraph (b), payments of amounts that are not gratuitous transfers (within the meaning of §1.671-2(e)(2)) are not amounts distributable. For the definition of *grantor*, see §1.671-2(e).

(2) *Amounts distributable in discharge of legal obligations—(i) In general.* A trust (or portion of a trust) does not fail to satisfy paragraph (b)(1) of this section solely because amounts are distributable from the trust (or portion thereof) in discharge of a legal obligation of the grantor or the spouse of the grantor. Subject to the provisions of paragraph (b)(2)(ii) of this section, an obligation is considered a legal obligation for purposes of this paragraph (b)(2)(i) if it is enforceable under the local law of the jurisdiction in which the grantor (or the spouse of the grantor) resides.

(ii) *Related parties—(A) In general.* Except as provided in paragraph (b)(2)(ii)(B) of this section, an obligation to a person who is a related person for purposes of §1.643(h)-1(e) (other than an individual who is legally separated from the grantor under a decree of divorce or of separate maintenance) is not a legal obligation for purposes of paragraph (b)(2)(i) of this section unless it was contracted bona fide and for adequate and full consideration in money or money's worth (see §20.2043-1 of this chapter).

(B) *Exceptions—(1) Amounts distributable in support of certain individuals.* Paragraph (b)(2)(ii)(A) of this section does not apply with respect to amounts that are distributable from the trust (or portion thereof) to support an individual who—

(i) Would be treated as a dependent of the grantor or the spouse of the grantor under section 152(a)(1) through (9), without regard to the requirement that over half of the individual's support be received from the grantor or the spouse of the grantor; and

(ii) Is either permanently and totally disabled (within the meaning of section 22(e)(3)), or less than 19 years old.

(2) *Certain potential support obligations.* The fact that amounts might become distributable from a trust (or portion of a trust) in discharge of a potential obligation under local law to support an individual other than an individual described in paragraph (b)(2)(ii)(B)(1) of this section is disregarded if such potential obligation is not reasonably expected to arise under the facts and circumstances.

(3) *Reinsurance trusts.* [Reserved]

(3) *Grandfather rule for certain section 677 trusts in existence on September 19, 1995.* Subject to the rules of paragraph (d) of this section (relating to separate accounting for gratuitous transfers to the trust after September 19, 1995), the general rule of § 1.672(f)-1 does not apply to any portion of a trust that was treated as owned by the grantor under section 677 (other than section 677(a)(3)) on September 19, 1995, as long as the trust would continue to be so treated thereafter. However, the preceding sentence does not apply to any portion of the trust attributable to gratuitous transfers to the trust after September 19, 1995.

(4) *Examples.* The following examples illustrate the rules of this paragraph (b):

*Example 1. Amounts distributable only to grantor or grantor's spouse.* H and his wife, W, are both nonresident aliens. H is 70 years old, and W is 65. H and W have a 30-year-old child, C, a resident alien. There is no reasonable expectation that H or W will ever have an obligation under local law to support C or any other individual. H creates and funds an irrevocable trust, FT, using only his separate property. H is the grantor of FT within the meaning of § 1.671-2(e). Under the terms of FT, the only amounts distributable (whether income or corpus) from FT as long as either H or W is alive are amounts distributable to H or W. Upon the death of both H and W, C may receive distributions from FT. During H's lifetime, the exception in paragraph (b)(1) of this section is applicable.

*Example 2. Effect of grantor's death.* Assume the same facts as in *Example 1*. H predeceases W. Assume that W would be treated as owning FT under section 678 if the grantor trust rules were applied without regard to section 672(f). The exception in paragraph (b)(1) of this section is no longer applicable, because W is not a grantor of FT within the meaning of § 1.671-2(e).

*Example 3. Amounts temporarily distributable to person other than grantor or grantor's spouse.* Assume the same facts as in *Example 1*, except that C (age 30) is a law student at the time FT is created and the trust instrument provides that, as long as C is in law school, amounts may be distributed from FT to pay C's expenses. Thereafter, the only amounts distributable from FT as long as either H or W is alive will be amounts distributable to H or W. Even assuming there is an enforceable obligation under local law for H and W to support C while he is in school, distributions from FT in payment of C's expenses cannot qualify as distributions in discharge of a legal obligation under paragraph (b)(2) of this section, because C is neither permanently and totally disabled nor less than 19 years old. The exception in paragraph (b)(1) of this section is not applicable. After C graduates from law school, the exception in paragraph (b)(1) still will not be applicable, because amounts were distributable to C during the lifetime of H.

*Example 4. Fixed investment trust.* FC, a foreign corporation, invests in a domestic fixed investment trust, DT, that is classified as a trust under § 301.7701-4(c)(1) of this chapter. Under the terms of DT, the only amounts that are distributable from FC's portion of DT are amounts distributable to FC. The exception in paragraph (b)(1) of this section is applicable to FC's portion of DT.

*Example 5. Reinsurance trust.* A domestic insurance company, DI, reinsures a portion of its business with an unrelated foreign insurance company, FI. To satisfy state regulatory requirements, FI places the premiums in an irrevocable domestic trust, DT. The trust funds are held by a United States bank and may be used only to pay claims arising out of the reinsurance policies, which are legally enforceable under the local law of the jurisdiction in which FI resides. On the termination of DT, any assets remaining will revert to FI. Because the only amounts that are distributable from DT are distributable either to FI or in discharge of FI's legal obligations within the meaning of paragraph (b)(2)(i) of this section, the exception in paragraph (b)(1) of this section is applicable.

*Example 6. Trust that provides security for loan.* FC, a foreign corporation, borrows money from B, an unrelated bank, to finance the purchase of an airplane. FC creates a foreign trust, FT, to hold the airplane as security for the loan from B. The only amounts that are distributable from FT while the

loan is outstanding are amounts distributable to B in the event that FC defaults on its loan from B. When FC repays the loan, the trust assets will revert to FC. The loan is a legal obligation of FC within the meaning of paragraph (b)(2)(i) of this section, because it is enforceable under the local law of the country in which FC is incorporated. Paragraph (b)(2)(ii) of this section is not applicable, because B is not a related person for purposes of § 1.643(h)-1(e). The exception in paragraph (b)(1) of this section is applicable.

(c) *Compensatory trusts*—(1) *In general.* The general rule of § 1.672(f)-1 does not apply to any portion of—

(i) A nonexempt employees' trust described in section 402(b), including a trust created on behalf of a self-employed individual;

(ii) A trust, including a trust created on behalf of a self-employed individual, that would be a nonexempt employees' trust described in section 402(b) but for the fact that the trust's assets are not set aside from the claims of creditors of the actual or deemed transferor within the meaning of § 1.83-3(e); and

(iii) Any additional category of trust that the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(2) *Exceptions.* The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), designate categories of compensatory trusts to which the general rule of paragraph (c)(1) of this section does not apply.

(d) *Separate accounting for gratuitous transfers to grandfathered trusts after September 19, 1995.* If a trust that was treated as owned by the grantor under section 676 or 677 (other than section 677(a)(3)) on September 19, 1995, contains both amounts held in the trust on September 19, 1995, and amounts that were gratuitously transferred to the trust after September 19, 1995, paragraphs (a)(3) and (b)(3) of this section apply only if the amounts that were gratuitously transferred to the trust after September 19, 1995, are treated as a separate portion of the trust that is accounted for under the rules of § 1.671-3(a)(2). If the amounts that were gratuitously transferred to the trust after September 19, 1995 are not so accounted

for, the general rule of § 1.672(f)-1 applies to the entire trust. If such amounts are so accounted for, and without regard to whether there is physical separation of the assets, the general rule of § 1.672(f)-1 does not apply to the portion of the trust that is attributable to amounts that were held in the trust on September 19, 1995.

(e) *Effective date.* The rules of this section are generally applicable to taxable years of a trust beginning after August 10, 1999. The initial separate accounting required by paragraph (d) of this section must be prepared by the due date (including extensions) for the tax return of the trust for the first taxable year of the trust beginning after August 10, 1999.

[T.D. 8831, 64 FR 43276, Aug. 10, 1999, as amended by T.D. 8890, 65 FR 41334, July 5, 2000]

#### § 1.672(f)-4 Recharacterization of purported gifts.

(a) *In general*—(1) *Purported gifts from partnerships.* Except as provided in paragraphs (b), (e), and (f) of this section, and without regard to the existence of any trust, if a United States person (United States donee) directly or indirectly receives a purported gift or bequest (as defined in paragraph (d) of this section) from a partnership, the purported gift or bequest must be included in the United States donee's gross income as ordinary income.

(2) *Purported gifts from foreign corporations.* Except as provided in paragraphs (b), (e), and (f) of this section, and without regard to the existence of any trust, if a United States donee directly or indirectly receives a purported gift or bequest (as defined in paragraph (d) of this section) from any foreign corporation, the purported gift or bequest must be included in the United States donee's gross income as if it were a distribution from the foreign corporation. If the foreign corporation is a passive foreign investment company (within the meaning of section 1297), the rules of section 1291 apply. For purposes of section 1012, the United States donee is not treated as having basis in the stock of the foreign corporation. However, for purposes of section 1223, the United States donee is treated as having a

holding period in the stock of the foreign corporation on the date of the deemed distribution equal to the weighted average of the holding periods of the actual interest holders (other than any interest holders who treat the portion of the purported gift attributable to their interest in the foreign corporation in the manner described in paragraph (b)(1) of this section). For purposes of section 902, a United States donee that is a domestic corporation is not treated as owning any voting stock of the foreign corporation.

(b) *Exceptions*—(1) *Partner or shareholder treats transfer as distribution and gift.* Paragraph (a) of this section does not apply to the extent the United States donee can demonstrate to the satisfaction of the Commissioner that either—

(i) A United States citizen or resident alien individual who directly or indirectly holds an interest in the partnership or foreign corporation treated and reported the purported gift or bequest for United States tax purposes as a distribution to such individual and a subsequent gift or bequest to the United States donee; or

(ii) A nonresident alien individual who directly or indirectly holds an interest in the partnership or foreign corporation treated and reported the purported gift or bequest for purposes of the tax laws of the nonresident alien individual's country of residence as a distribution to such individual and a subsequent gift or bequest to the United States donee, and the United States donee timely complied with the reporting requirements of section 6039F, if applicable.

(2) *All beneficial owners of domestic partnership are United States citizens or residents or domestic corporations.* Paragraph (a)(1) of this section does not apply to a purported gift or bequest from a domestic partnership if the United States donee can demonstrate to the satisfaction of the Commissioner that all beneficial owners (within the meaning of § 1.1441-1(c)(6)) of the partnership are United States citizens or residents or domestic corporations.

(3) *Contribution to capital of corporate United States donee.* Paragraph (a) of this section does not apply to the extent a United States donee that is a

corporation can establish that the purported gift or bequest was treated for United States tax purposes as a contribution to the capital of the United States donee to which section 118 applies.

(4) *Charitable transfers.* Paragraph (a) of this section does not apply if either—

(i) The United States donee is described in section 170(c); or

(ii) The transferor has received a ruling or determination letter, which has been neither revoked nor modified, from the Internal Revenue Service recognizing its exempt status under section 501(c)(3), and the transferor made the transfer pursuant to an exempt purpose for which the transferor was created or organized. For purposes of the preceding sentence, a ruling or determination letter recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization.

(c) *Certain transfers from trusts to which a partnership or foreign corporation has made a gratuitous transfer*—(1) *Generally treated as distribution from partnership or foreign corporation.* Except as provided in paragraphs (c)(2) and (3) of this section, if a United States donee receives a gratuitous transfer (within the meaning of § 1.671-2(e)(2)) from a trust (or portion of a trust) to which a partnership or foreign corporation has made a gratuitous transfer, the United States donee must treat the transfer as a purported gift or bequest from the partnership or foreign corporation that is subject to the rules of paragraph (a) of this section (including the exceptions in paragraphs (b) and (f) of this section). This paragraph (c) applies without regard to who is treated as the grantor of the trust (or portion thereof) under § 1.671-2(e)(4).

(2) *Alternative rule.* Except as provided in paragraph (c)(3) of this section, if the United States tax computed under the rules of paragraphs (a) and (c)(1) of this section does not exceed the United States tax that would be due if the United States donee treated the transfer as a distribution from the trust (or portion thereof), paragraph (c)(1) of this section does not apply and

the United States donee must treat the transfer as a distribution from the trust (or portion thereof) that is subject to the rules of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code. For purposes of paragraph (f) of this section, the transfer is treated as a purported gift or bequest from the partnership or foreign corporation that made the gratuitous transfer to the trust (or portion thereof).

(3) *Exception.* Neither paragraph (c)(1) of this section nor paragraph (c)(2) of this section applies to the extent the United States donee can demonstrate to the satisfaction of the Commissioner that the transfer represents an amount that is, or has been, taken into account for United States tax purposes by a United States citizen or resident or a domestic corporation. A transfer will be deemed to be made first out of amounts that have not been taken into account for United States tax purposes by a United States citizen or resident or a domestic corporation, unless the United States donee can demonstrate to the satisfaction of the Commissioner that another ordering rule is more appropriate.

(d) *Definition of purported gift or bequest—(1) In general.* Subject to the provisions of paragraphs (d)(2) and (3) of this section, a *purported gift or bequest* for purposes of this section is any transfer of property by a partnership or foreign corporation other than a transfer for fair market value (within the meaning of § 1.671-2(e)(2)(ii)) to a person who is not a partner in the partnership or a shareholder of the foreign corporation (or to a person who is a partner in the partnership or a shareholder of a foreign corporation, if the amount transferred is inconsistent with the partner's interest in the partnership or the shareholder's interest in the corporation, as the case may be). For purposes of this section, the term *property* includes cash.

(2) *Transfers for less than fair market value—(i) Excess treated as purported gift or bequest.* Except as provided in paragraph (d)(2)(ii) of this section, if a transfer described in paragraph (d)(1) of this section is for less than fair market value, the excess of the fair market

value of the property transferred over the value of the property received, services rendered, or the right to use property is treated as a purported gift or bequest.

(ii) *Exception for transfers to unrelated parties.* No portion of a transfer described in paragraph (d)(1) of this section will be treated as a purported gift or bequest for purposes of this section if the United States donee can demonstrate to the satisfaction of the Commissioner that the United States donee is not related to a partner or shareholder of the transferor within the meaning of § 1.643(h)-1(e) or does not have another relationship with a partner or shareholder of the transferor that establishes a reasonable basis for concluding that the transferor would make a gratuitous transfer to the United States donee.

(e) *Prohibition against affirmative use of recharacterization by taxpayers.* A taxpayer may not use the rules of this section if a principal purpose for using such rules is the avoidance of any tax imposed by the Internal Revenue Code. Thus, with respect to such taxpayer, the Commissioner may depart from the rules of this section and recharacterize (for all purposes of the Internal Revenue Code) the transfer in accordance with its form or its economic substance.

(f) *Transfers not in excess of \$10,000.* This section does not apply if, during the taxable year of the United States donee, the aggregate amount of purported gifts or bequests that is transferred to such United States donee directly or indirectly from all partnerships or foreign corporations that are related (within the meaning of section 643(i)) does not exceed \$10,000. The aggregate amount must include gifts or bequests from persons that the United States donee knows or has reason to know are related to the partnership or foreign corporation (within the meaning of section 643(i)).

(g) *Examples.* The following examples illustrate the rules of this section. In each example, the amount that is transferred exceeds \$10,000. The examples are as follows:

*Example 1. Distribution from foreign corporation.* FC is a foreign corporation that is wholly owned by A, a nonresident alien who is

resident in Country C. FC makes a gratuitous transfer of property directly to A's daughter, B, who is a resident alien. Under paragraph (a)(2) of this section, B generally must treat the transfer as a dividend from FC to the extent of FC's earnings and profits and as an amount received in excess of basis thereafter. If FC is a passive foreign investment company, B must treat the amount received as a distribution under section 1291. B will be treated as having the same holding period as A. However, under paragraph (b)(1)(ii) of this section, if B can establish to the satisfaction of the Commissioner that, for purposes of the tax laws of Country C, A treated (and reported, if applicable) the transfer as a distribution to himself and a subsequent gift to B, B may treat the transfer as a gift (provided B timely complied with the reporting requirements of section 6039F, if applicable).

*Example 2. Distribution of corpus from trust to which foreign corporation made gratuitous transfer.* FC is a foreign corporation that is wholly owned by A, a nonresident alien who is resident in Country C. FC makes a gratuitous transfer to a foreign trust, FT, that has no other assets. FT immediately makes a gratuitous transfer in the same amount to A's daughter, B, who is a resident alien. Under paragraph (c)(1) of this section, B must treat the transfer as a transfer from FC that is subject to the rules of paragraph (a)(2) of this section. Under paragraph (a)(2) of this section, B must treat the transfer as a dividend from FC unless she can establish to the satisfaction of the Commissioner that, for purposes of the tax laws of Country C, A treated (and reported, if applicable) the transfer as a distribution to himself and a subsequent gift to B and that B timely complied with the reporting requirements of section 6039F, if applicable. The alternative rule in paragraph (c)(2) of this section would not apply as long as the United States tax computed under the rules of paragraph (a)(2) of this section is equal to or greater than the United States tax that would be due if the transfer were treated as a distribution from FT.

*Example 3. Accumulation distribution from trust to which foreign corporation made gratuitous transfer.* FC is a foreign corporation that is wholly owned by A, a nonresident alien. FC is not a passive foreign investment company (as defined in section 1297). FC makes a gratuitous transfer of 100X to a foreign trust, FT, on January 1, 2001. FT has no other assets on January 1, 2001. Several years later, FT makes a gratuitous transfer of 1000X to A's daughter, B, who is a United States resident. Assume that the section 668 interest charge on accumulation distributions will apply if the transfer is treated as a distribution from FT. Under the alternative rule of paragraph (c)(2) of this section, B must treat the transfer as an accumula-

tion distribution from FT, because the resulting United States tax liability is greater than the United States tax that would be due if the transfer were treated as a transfer from FC that is subject to the rules of paragraph (a) of this section.

*Example 4. Transfer from trust that is treated as owned by United States citizen.* Assume the same facts as in *Example 3*, except that A is a United States citizen. Assume that A treats and reports the transfer to FT as a constructive distribution to himself, followed by a gratuitous transfer to FT, and that A is properly treated as the grantor of FT within the meaning of § 1.671-2(e). A is treated as the owner of FT under section 679 and, as required by section 671 and the regulations thereunder, A includes all of FT's items of income, deductions, and credit in computing his taxable income and credits. Neither paragraph (c)(1) nor paragraph (c)(2) of this section is applicable, because the exception in paragraph (c)(3) of this section applies.

*Example 5. Transfer for less than fair market value.* FC is a foreign corporation that is wholly owned by A, a nonresident alien. On January 15, 2001, FC transfers property directly to A's daughter, B, a resident alien, in exchange for 90X. The Commissioner later determines that the fair market value of the property at the time of the transfer was 100X. Under paragraph (d)(2)(i) of this section, 10X will be treated as a purported gift to B on January 15, 2001.

(h) *Effective date.* The rules of this section are generally applicable to any transfer after August 10, 1999, by a partnership or foreign corporation, or by a trust to which a partnership or foreign corporation makes a gratuitous transfer after August 10, 1999.

[T.D. 8831, 64 FR 43278, Aug. 10, 1999, as amended by T.D. 8890, 65 FR 41334, July 5, 2000]

#### § 1.672(f)-5 Special rules.

(a) *Transfers by certain beneficiaries to foreign grantor—(1) In general.* If, but for section 672(f)(5), a foreign person would be treated as the owner of any portion of a trust, any United States beneficiary of the trust is treated as the grantor of a portion of the trust to the extent the United States beneficiary directly or indirectly made transfers of property to such foreign person (without regard to whether the United States beneficiary was a United States beneficiary at the time of any transfer) in excess of transfers to the United States beneficiary from the foreign

person. The rule of this paragraph (a) does not apply to the extent the United States beneficiary can demonstrate to the satisfaction of the Commissioner that the transfer by the United States beneficiary to the foreign person was wholly unrelated to any transaction involving the trust. For purposes of this paragraph (a), the term property includes cash, and a transfer of property does not include a transfer that is not a gratuitous transfer (within the meaning of § 1.671-2(e)(2)). In addition, a gift is not taken into account to the extent such gift would not be characterized as a taxable gift under section 2503(b). For a definition of United States beneficiary, see section 679.

(2) *Examples.* The following examples illustrate the rules of this section:

*Example 1.* A, a nonresident alien, contributes property to FC, a foreign corporation that is wholly owned by A. FC creates a foreign trust, FT, for the benefit of A and A's children. FT is revocable by FC without the approval or consent of any other person. FC funds FT with the property received from A. A and A's family move to the United States. Under paragraph (a)(1) of this section, A is treated as a grantor of FT. (A may also be treated as an owner of FT under section 679(a)(4).)

*Example 2.* B, a United States citizen, makes a gratuitous transfer of \$1 million to B's uncle, C, a nonresident alien. C creates a foreign trust, FT, for the benefit of B and B's children. FT is revocable by C without the approval or consent of any other person. C funds FT with the property received from B. Under paragraph (a)(1) of this section, B is treated as a grantor of FT. (B also would be treated as an owner of FT as a result of section 679.)

(b) *Entity characterization.* Entities generally are characterized under United States tax principles for purposes of §§ 1.672(f)-1 through 1.672(f)-5. See §§ 301.7701-1 through 301.7701-4 of this chapter. However, solely for purposes of § 1.672(f)-4, a transferor that is a wholly owned business entity is treated as a corporation, separate from its single owner.

(c) *Effective date.* The rules in paragraph (a) of this section are applicable to transfers to trusts on or after August 10, 1999. The rules in paragraph (b)

of this section are applicable August 10, 1999.

[T.D. 8831, 64 FR 43280, Aug. 10, 1999, as amended by T.D. 8890, 65 FR 41334, July 5, 2000]

**§ 1.673(a)-1 Reversionary interests; income payable to beneficiaries other than certain charitable organizations; general rule.**

(a) Under section 673(a), a grantor, in general, is treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or income if, as of the inception of that portion of the trust, the grantor's interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years commencing with the date of transfer of that portion of the trust. However, the following types of reversionary interests are excepted from the general rule of the preceding sentence:

(1) A reversionary interest after the death of the income beneficiary of a trust (see paragraph (b) of this section); and

(2) Except in the case of transfers in trust made after April 22, 1969, a reversionary interest in a charitable trust meeting the requirements of section 673(b) (see § 1.673(b)-1). Even though the duration of the trust may be such that the grantor is not treated as its owner under section 673, and therefore is not taxed on the ordinary income, he may nevertheless be treated as an owner under section 677(a)(2) if he has a reversionary interest in the corpus. In the latter case, items of income, deduction, and credit allocable to corpus, such as capital gains and losses, will be included in the portion he owns. See § 1.671-3 and the regulations under section 677. See § 1.673(d)-1 with respect to a postponement of the date specified for reacquisition of a reversionary interest.

(b) Section 673(c) provides that a grantor is not treated as the owner of any portion of a trust by reason of section 673 if his reversionary interest in the portion is not to take effect in possession or enjoyment until the death of the person or persons to whom the income of the portion is regardless of the life expectancies of the income beneficiaries. If his reversionary interest is

**§ 1.673(b)-1**

**26 CFR Ch. I (4-1-12 Edition)**

to take effect on or after the death of an income beneficiary or upon the expiration of a specific term of years, whichever is earlier, the grantor is treated as the owner if the specific term of years is less than 10 years (but not if the term is 10 years or longer).

(c) Where the grantor's reversionary interest in a portion of a trust is to take effect in possession or enjoyment by reason of some event other than the expiration of a specific term of years or the death of the income beneficiary, the grantor is treated as the owner of the portion if the event may reasonably be expected to occur within 10 years from the date of transfer of that portion, but he is not treated as the owner under section 673 if the event may not reasonably be expected to occur within 10 years from that date. For example, if the reversionary interest in any portion of a trust is to take effect on or after the death of the grantor (or any person other than the person to whom the income is payable) the grantor is treated under section 673 as the owner of the portion if the life expectancy of the grantor (or other person) is less than 10 years on the date of transfer of the portion, but not if the life expectancy is 10 years or longer. If the reversionary interest in any portion is to take effect on or after the death of the grantor (or any person other than the person to whom the income is payable) or upon the expiration of a specific term of years, whichever is earlier, the grantor is treated as the owner of the portion if on the date of transfer of the portion either the life expectancy of the grantor (or other person) or the specific term is less than 10 years; however, if both the life expectancy and the specific term are 10 years or longer the grantor is not treated as the owner of the portion under section 673. Similarly, if the grantor has a reversionary interest in any portion which will take effect at the death of the income beneficiary or the grantor, whichever is earlier, the grantor is not treated as an owner of the portion unless his life expectancy is less than 10 years.

(d) It is immaterial that a reversionary interest in corpus or income is subject to a contingency if the reversionary interest may, taking the con-

tingency into consideration, reasonably be expected to take effect in possession or enjoyment within 10 years. For example, the grantor is taxable where the trust income is to be paid to the grantor's son for 3 years, and the corpus is then to be returned to the grantor if he survives that period, or to be paid to the grantor's son if he is already deceased.

(e) See section 671 and §§1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit when a person is treated as the owner of all or only a portion of a trust.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7357, 40 FR 23742, June 2, 1975]

**§ 1.673(b)-1 Income payable to charitable beneficiaries before amendment by Tax Reform Act of 1969).**

(a) Pursuant to section 673(b) a grantor is not treated as an owner of any portion of a trust under section 673, even though he has a reversionary interest which will take effect within 10 years, to the extent that, under the terms of the trust, the income of the portion is irrevocably payable for a period of at least 2 years (commencing with the date of the transfer) to a designated beneficiary of the type described in section 170(b)(1)(A).

(b) Income must be irrevocably payable to a designated beneficiary for at least 2 years commencing with the date of the transfer before the benefit of section 673(b) will apply. Thus, section 673(b) will not apply if income of a trust is irrevocably payable to University A for 1 year and then to University B for the next year; or if income of a trust may be allocated among two or more charitable beneficiaries in the discretion of the trustee or any other person. On the other hand, section 673(b) will apply if half the income of a trust is irrevocably payable to University A and the other half is irrevocably payable to University B for two years.

(c) Section 673(b) applies to the period of 2 years or longer during which income is paid to a designated beneficiary of the type described in section 170(b)(1)(A) (i), (ii), or (iii), even though the trust term is to extend beyond that period. However, the other provisions of section 673 apply to the part of the

trust term, if any, that extends beyond that period. This paragraph may be illustrated by the following example:

*Example.* G transfers property in trust with the ordinary income payable to University C (which qualifies under section 170(b)(1)(A)(ii)) for 3 years, and then to his son, B, for 5 years. At the expiration of the term the trust reverts to G. G is not taxed under section 673 of the trust income payable to University C for the first 3 years because of the application of section 673(b). However, he is taxed on income for the next 5 years because he has a reversionary interest which will take effect within 10 years commencing with the date of the transfer. On the other hand, if the income were payable to University C for 3 years and then to R for 7 years so that the trust corpus would not be returned to G within 10 years, G would not be taxable under section 673 on income payable to University C and to B during any part of the term.

(d) This section does not apply to transfers in trust made after April 22, 1969.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D., 6605, 27 FR 8097, Aug. 15, 1962; T.D. 7357, 40 FR 23743, June 2, 1975]

**§ 1.673(c)-1 Reversionary interest after income beneficiary's death.**

The subject matter of section 673(c) is covered in paragraph (b) of § 1.673(a)-1.

**§ 1.673(d)-1 Postponement of date specified for reacquisition.**

Any postponement of the date specified for the reacquisition of possession or enjoyment of any reversionary interest is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. However, the grantor will not be treated as the owner of any portion of a trust for any taxable year by reason of the foregoing sentence if he would not be so treated in the absence of any postponement. The rules contained in this section may be illustrated by the following example:

*Example.* G places property in trust for the benefit of his son B. Upon the expiration of 12 years or the earlier death of B the property is to be paid over to G or his estate. After the expiration of 9 years G extends the term of the trust for an additional 2 years. G

is considered to have made a new transfer in trust for a term of 5 years (the remaining 3 years of the original transfer plus the 2-year extension). However, he is not treated as the owner of the trust under section 673 for the first 3 years of the new term because he would not be so treated if the term of the trust had not been extended. G is treated as the owner of the trust, however, for the remaining 2 years.

**§ 1.674(a)-1 Power to control beneficial enjoyment; scope of section 674.**

(a) Under section 674, the grantor is treated as the owner of a portion of trust if the grantor or a nonadverse party has a power, beyond specified limits, to dispose of the beneficial enjoyment of the income or corpus, whether the power is a fiduciary power, a power of appointment, or any other power. Section 674(a) states in general terms that the grantor is treated as the owner in every case in which he or a nonadverse party can affect the beneficial enjoyment of a portion of a trust, the limitations being set forth as exceptions in subsections (b), (c), and (d) of section 674. These exceptions are discussed in detail in §§ 1.674(b)-1 through 1.674(d)-1. Certain limitations applicable to section 674 (b), (c), and (d) are set forth in § 1.674(d)-2. Section 674(b) describes powers which are excepted regardless of who holds them. Section 674(c) describes additional powers of trustees which are excepted if at least half the trustees are independent, and if the grantor is not a trustee. Section 674(d) describes a further power which is excepted if it is held by trustees other than the grantor or his spouse (if living with the grantor).

(b) In general terms the grantor is treated as the owner of a portion of a trust if he or a nonadverse party or both has a power to dispose of the beneficial enjoyment of the corpus or income unless the power is one of the following:

(1) *Miscellaneous powers over either ordinary income or corpus.* (i) A power that can only affect the beneficial enjoyment of income (including capital gains) received after a period of time such that the grantor would not be treated as an owner under section 673 if the power were a reversionary interest (section 674(b)(2));

## § 1.674(b)-1

## 26 CFR Ch. I (4-1-12 Edition)

(ii) A testamentary power held by anyone (other than a testamentary power held by the grantor over accumulated income) (section 674(b)(3));

(iii) A power to choose between charitable beneficiaries or to affect the manner of their enjoyment of a beneficial interest (section 674(b)(4));

(iv) A power to allocate receipts and disbursements between income and corpus (section 674(b)(8)).

(2) *Powers of distribution primarily affecting only one beneficiary.* (i) A power to distribute corpus to or for a current income beneficiary, if the distribution must be charged against the share of corpus from which the beneficiary may receive income (section 674(b)(5)(B));

(ii) A power to distribute income to or for a current income beneficiary or to accumulate it either (a) if accumulated income must either be payable to the beneficiary from whom it was withheld or as described in paragraph (b)(6) of § 1.674(b)-1 (section 674(b)(6)); (b) if the power is to apply income to the support of a dependent of the grantor, and the income is not so applied (section 674(b)(1)); or (c) if the beneficiary is under 21 or under a legal disability and accumulated income is added to corpus (section 674(b)(7)).

(3) *Powers of distribution affecting more than one beneficiary.* A power to distribute corpus or income to or among one or more beneficiaries or to accumulate income, either (i) if the power is held by a trustee or trustees other than the grantor, at least half of whom are independent (section 674(c)), or (ii) if the power is limited by a reasonably definite standard in the trust instrument, and in the case of a power over income, if in addition the power is held by a trustee or trustees other than the grantor and the grantor's spouse living with the grantor (section 674(b)(5)(A) and (d)). (These powers include both powers to "sprinkle" income or corpus among current beneficiaries, and powers to shift income or corpus between current beneficiaries and remaindermen; however, certain of the powers described under subparagraph (2) of this paragraph can have the latter effect incidentally.)

(c) See section 671 and §§ 1.671-2 and 1.671-3 for rules for the treatment of income, deductions, and credits when a

person is treated as the owner of all or only a portion of a trust.

### § 1.674(b)-1 Excepted powers exercisable by any person.

(a) Paragraph (b) (1) through (8) of this section sets forth a number of powers which may be exercisable by any person without causing the grantor to be treated as an owner of a trust under section 674(a). Further, with the exception of powers described in paragraph (b)(1) of this section, it is immaterial whether these powers are held in the capacity of trustee. It makes no difference under section 674(b) that the person holding the power is the grantor, or a related or subordinate party (with the qualifications noted in paragraph (b) (1) and (3) of this section).

(b) The exceptions referred to in paragraph (a) of this section are as follows (see, however, the limitations set forth in § 1.674(d)-2):

(1) *Powers to apply income to support of a dependent.* Section 674(b)(1) provides, in effect, that regardless of the general rule of section 674(a), the income of a trust will not be considered as taxable to the grantor merely because in the discretion of any person (other than a grantor who is not acting as a trustee or cotrustee) it may be used for the support of a beneficiary whom the grantor is legally obligated to support, except to the extent that it is in fact used for that purpose. See section 677(b) and the regulations thereunder.

(2) *Powers affecting beneficial enjoyment only after a period.* Section 674(b)(2) provides an exception to section 674(a) if the exercise of a power can only affect the beneficial enjoyment of the income of a trust received after a period of time which is such that a grantor would not be treated as an owner under section 673 if the power were a reversionary interest. See §§ 1.673(a)-1 and 1.673(b)-1. For example, if a trust created on January 1, 1955, provides for the payment of income to the grantor's son, and the grantor reserves the power to substitute other beneficiaries of income or corpus in lieu of his son on or after January 1, 1965, the grantor is not treated under section 674 as the owner of the trust with respect to ordinary income received before January 1, 1965. But the

grantor will be treated as an owner on and after that date unless the power is relinquished. If the beginning of the period during which the grantor may substitute beneficiaries is postponed, the rules set forth in §1.673(d)-1 are applicable in order to determine whether the grantor should be treated as an owner during the period following the postponement.

(3) *Testamentary powers.* Under paragraph (3) of section 674(b) a power in any person to control beneficial enjoyment exercisable only by will does not cause a grantor to be treated as an owner under section 674(a). However, this exception does not apply to income accumulated for testamentary disposition by the grantor or to income which may be accumulated for such distribution in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party. For example, if a trust instrument provides that the income is to be accumulated during the grantor's life and that the grantor may appoint the accumulated income by will, the grantor is treated as the owner of the trust. Moreover, if a trust instrument provides that the income is payable to another person for his life, but the grantor has a testamentary power of appointment over the remainder, and under the trust instrument and local law capital gains are added to corpus, the grantor is treated as the owner of a portion of the trust and capital gains and losses are included in that portion. (See §1.671-3.)

(4) *Powers to determine beneficial enjoyment of charitable beneficiaries.* Under paragraph (4) of section 674(b) a power in any person to determine the beneficial enjoyment of corpus or income which is irrevocably payable (currently or in the future) for purposes specified in section 170(c) (relating to definition of charitable contributions) will not cause the grantor to be treated as an owner under section 674(a). For example, if a grantor creates a trust, the income of which is irrevocably payable solely to educational or other organizations that qualify under section 170(c), he is not treated as an owner under section 674 although he retains the power to allocate the income among such organizations.

(5) *Powers to distribute corpus.* Paragraph (5) of section 674(b) provides an exception to section 674(a) for powers to distribute corpus, subject to certain limitations, as follows:

(i) If the power is limited by a reasonably definite standard which is set forth in the trust instrument, it may extend to corpus distributions to any beneficiary or beneficiaries or class of beneficiaries (whether income beneficiaries or remaindermen) without causing the grantor to be treated as an owner under section 674. See section 674(b)(5)(A). It is not required that the standard consist of the needs and circumstances of the beneficiary. A clearly measurable standard under which the holder of a power is legally accountable is deemed a reasonably definite standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; or to enable him to maintain his accustomed standard of living; or to meet an emergency, would be limited by a reasonably definite standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not limited by a reasonably definite standard. The entire context of a provision of a trust instrument granting a power must be considered in determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no reasonably definite standard exists.

(ii) If the power is not limited by a reasonably definite standard set forth in the trust instrument, the exception applies only if distributions of corpus may be made solely in favor of current income beneficiaries, and any corpus distribution to the current income beneficiary must be chargeable against the proportionate part of corpus held in trust for payment of income to that

beneficiary as if it constituted a separate trust (whether or not physically segregated). See section 674(b)(5)(B).

(iii) This subparagraph may be illustrated by the following examples:

*Example 1.* A trust instrument provides for payment of the income to the grantor's two brothers for life, and for payment of the corpus to the grantor's nephews in equal shares. The grantor reserves the power to distribute corpus to pay medical expenses that may be incurred by his brothers or nephews. The grantor is not treated as an owner by reason of this power because section 674(b)(5)(A) excepts a power, exercisable by any person, to invade corpus for any beneficiary, including a remainderman, if the power is limited by a reasonably definite standard which is set forth in the trust instrument. However, if the power were also exercisable in favor of a person (for example, a sister) who was not otherwise a beneficiary of the trust, section 674(b)(5)(A) would not be applicable.

*Example 2.* The facts are the same as in example 1 except that the grantor reserves the power to distribute any part of the corpus to his brothers or to his nephews for their happiness. The grantor is treated as the owner of the trust. Paragraph (5)(A) of section 674(b) is inapplicable because the power is not limited by a reasonably definite standard. Paragraph (5)(B) is inapplicable because the power to distribute corpus permits a distribution of corpus to persons other than current income beneficiaries.

*Example 3.* A trust instrument provides for payment of the income to the grantor's two adult sons in equal shares for 10 years, after which the corpus is to be distributed to his grandchildren in equal shares. The grantor reserves the power to pay over to each son up to one-half of the corpus during the 10-year period, but any such payment shall proportionately reduce subsequent income and corpus payments made to the son receiving the corpus. Thus, if one-half of the corpus is paid to one son, all the income from the remaining half is thereafter payable to the other son. The grantor is not treated as an owner under section 674(a) by reason of this power because it qualifies under the exception of section 674(b)(5)(B).

(6) *Powers to withhold income temporarily.* (i) Section 674(b)(6) excepts a power which, in general, enables the holder merely to effect a postponement in the time when the ordinary income is enjoyed by a current income beneficiary. Specifically, there is excepted a power to distribute or apply ordinary income to or for a current income beneficiary or to accumulate the income,

if the accumulated income must ultimately be payable either:

(a) To the beneficiary from whom it was withheld, his estate, or his appointees (or persons designated by name, as a class, or otherwise as alternate takers in default of appointment) under a power of appointment held by the beneficiary which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate (section 674(b)(6)(A));

(b) To the beneficiary from whom it was withheld, or if he does not survive a date of distribution which could reasonably be expected to occur within his lifetime, to his appointees (or alternate takers in default of appointment) under any power of appointment, general or special, or if he has no power of appointment to one or more designated alternate takers (other than the grantor or of the grantor's estate) whose shares have been irrevocably specified in the trust instrument (section 674(b)(6)(A) and the flush material following); or

(c) On termination of the trust, or in conjunction with a distribution of corpus which is augmented by the accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument, or if any beneficiary does not survive a date of distribution which would reasonably be expected to occur within his lifetime, to his appointees (or alternate takers in default of appointment) under any power of appointment, general or special, or if he has no power of appointment to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified in the trust instrument (section 674(b)(6)(B) and the flush material following).

(In the application of (a) of this subdivision, if the accumulated income of a trust is ultimately payable to the estate of the current income beneficiary or is ultimately payable to his appointees or takers in default of appointment, under a power of the type described in (a) of this subdivision, it need not be payable to the beneficiary from whom it was withheld under any circumstances. Furthermore, if a trust otherwise qualifies for the exception in

(a) of this subdivision the trust income will not be considered to be taxable to the grantor under section 677 by reason of the existence of the power of appointment referred to in (a) of this subdivision.) In general, the exception in section 674(b)(6) is not applicable if the power is in substance one to shift ordinary income from one beneficiary to another. Thus, a power will not qualify for this exception if ordinary income may be distributed to beneficiary A, or may be added to corpus which is ultimately payable to beneficiary B, a remainderman who is not a current income beneficiary. However, section 674(b)(6)(B), and (c) of this subdivision, permit a limited power to shift ordinary income among current income beneficiaries, as illustrated in example 1 of this subparagraph.

(ii) The application of section 674(b)(6) may be illustrated by the following examples:

*Example 1.* A trust instrument provides that the income shall be paid in equal shares to the grantor's two adult daughters but the grantor reserves the power to withhold from either beneficiary any part of that beneficiary's share of income and to add it to the corpus of the trust until the younger daughter reaches the age of 30 years. When the younger daughter reaches the age of 30, the trust is to terminate and the corpus is to be divided equally between the two daughters or their estates. Although exercise of this power may permit the shifting of accumulated income from one beneficiary to the other (since the corpus with the accumulations is to be divided equally) the power is excepted under section 674(b)(6)(B) and subdivision (i)(c) of this subparagraph.

*Example 2.* The facts are the same as in example 1, except that the grantor of the trust reserves the power to distribute accumulated income to the beneficiaries in such shares as he chooses. The combined powers are not excepted by section 674(b)(6)(B) since income accumulated pursuant to the first power is neither required to be payable only in conjunction with a corpus distribution nor required to be payable in shares specified in the trust instrument. See, however, section 674(c) and § 1.674(c)-1 for the effect of such a power if it is exercisable only by independent trustees.

*Example 3.* A trust provides for payment of income to the grantor's adult son with the grantor retaining the power to accumulate the income until the grantor's death, when all accumulations are to be paid to the son. If the son predeceases the grantor, all accumulations are, at the death of the grantor, to

be paid to his daughter, or if she is not living, to alternate takers (which do not include the grantor's estate) in specified shares. The power is excepted under section 674(b)(6)(A) since the date of distribution (the date of the grantor's death) may, in the usual case, reasonably be expected to occur during the beneficiary's (the son's) lifetime. It is not necessary that the accumulations be payable to the son's estate or his appointees if he should predecease the grantor for this exception to apply.

(7) *Power to withhold income during disability.* Section 674(b)(7) provides an exception for a power which, in general, will permit ordinary income to be withheld during the legal disability of an income beneficiary or while he is under 21. Specifically, there is excepted a power, exercisable only during the existence of a legal disability of any current income beneficiary or the period during which any income beneficiary is under the age of 21 years, to distribute or apply ordinary income to or for that beneficiary or to accumulate the income and add it to corpus. To qualify under this exception it is not necessary that the income ultimately be payable to the income beneficiary from whom it was withheld, his estate, or his appointees; that is, the accumulated income may be added to corpus and ultimately distributed to others. For example, the grantor is not treated as an owner under section 674 if the income of a trust is payable to his son for life, remainder to his grandchildren, although he reserves the power to accumulate income and add it to corpus while his son is under 21.

(8) *Powers to allocate between corpus and income.* Paragraph (8) of section 674(b) provides that a power to allocate receipts and disbursements between corpus and income, even though expressed in broad language, will not cause the grantor to be treated as an owner under the general rule of section 674(a).

**§ 1.674(c)-1 Excepted powers exercisable only by independent trustees.**

Section 674(c) provides an exception to the general rule of section 674(a) for certain powers that are exercisable by independent trustees. This exception is in addition to those provided for under section 674(b) which may be held by

### § 1.674(d)-1

any person including an independent trustee. The powers to which section 674(c) apply are powers (a) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, or (b) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries). In order for such a power to fall within the exception of section 674(c) it must be exercisable solely (without the approval or consent of any other person) by a trustee or trustees none of whom is the grantor and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor. (See section 672(c) for definitions of these terms.) An example of the application of section 674(c) is a trust whose income is payable to the grantor's three adult sons with power in an independent trustee to allocate without restriction the amounts of income to be paid to each son each year. Such a power does not cause the grantor to be treated as the owner of the trust. See however, the limitations set forth in § 1.674(d)-2.

#### **§ 1.674(d)-1 Excepted powers exercisable by any trustee other than grantor or spouse.**

Section 674(d) provides an additional exception to the general rule of section 674(a) for a power to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries or to, for, or within a class of beneficiaries, whether or not the conditions of section 674(b) (6) or (7) are satisfied, if the power is solely exercisable (without the approval or consent of any other person) by a trustee or trustees none of whom is the grantor or spouse living with the grantor, and if the power is limited by a reasonably definite external standard set forth in the trust instrument (see paragraph (b)(5) of § 1.674(b)-1 with respect to what constitutes a reasonably definite standard). See, however, the limitations set forth in § 1.674(d)-2.

#### **§ 1.674(d)-2 Limitations on exceptions in section 674 (b), (c), and (d).**

(a) *Power to remove trustee.* A power in the grantor to remove, substitute, or

### 26 CFR Ch. I (4-1-12 Edition)

add trustees (other than a power exercisable only upon limited conditions which do not exist during the taxable year, such as the death or resignation of, or breach of fiduciary duty by, an existing trustee) may prevent a trust from qualifying under section 674 (c) or (d). For example, if a grantor has an unrestricted power to remove an independent trustee and substitute any person including himself as trustee, the trust will not qualify under section 674 (c) or (d). On the other hand if the grantor's power to remove, substitute, or add trustees is limited so that its exercise could not alter the trust in a manner that would disqualify it under section 674 (c) or (d), as the case may be, the power itself does not disqualify the trust. Thus, for example, a power in the grantor to remove or discharge an independent trustee on the condition that he substitute another independent trustee will not prevent a trust from qualifying under section 674(c).

(b) *Power to add beneficiaries.* The exceptions described in section 674 (b) (5), (6), and (7), (c), and (d), are not applicable if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where the action is to provide for after-born or after-adopted children. This limitation does not apply to a power held by a beneficiary to substitute other beneficiaries to succeed to his interest in the trust (so that he would be an adverse party as to the exercise or nonexercise of that power). For example, the limitation does not apply to a power in a beneficiary of a nonspendthrift trust to assign his interest. Nor does the limitation apply to a power held by any person which would qualify as an exception under section 674(b)(3) (relating to testamentary powers).

#### **§ 1.675-1 Administrative powers.**

(a) *General rule.* Section 675 provides in effect that the grantor is treated as the owner of any portion of a trust if under the terms of the trust instrument or circumstances attendant on its operation administrative control is exercisable primarily for the benefit of

the grantor rather than the beneficiaries of the trust. If a grantor retains a power to amend the administrative provisions of a trust instrument which is broad enough to permit an amendment causing the grantor to be treated as the owner of a portion of the trust under section 675, he will be treated as the owner of the portion from its inception. See section 671 and §§ 1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit when a person is treated as the owner of all or only a portion of a trust.

(b) *Prohibited controls.* The circumstances which cause administrative controls to be considered exercisable primarily for the benefit of the grantor are specifically described in paragraphs (1) through (4) of section 675 as follows:

(1) The existence of a power, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party, which enables the grantor or any other person to purchase, exchange, or otherwise deal with or dispose of the corpus or the income of the trust for less than adequate consideration in money or money's worth. Whether the existence of the power itself will constitute the holder an adverse party will depend on the particular circumstances.

(2) The existence of a power exercisable by the grantor or a nonadverse party, or both, which enables the grantor to borrow the corpus or income of the trust, directly or indirectly, without adequate interest or adequate security. However, this paragraph does not apply where a trustee (other than the grantor acting alone) is authorized under a general lending power to make loans to any person without regard to interest or security. A general lending power in the grantor, acting alone as trustee, under which he has power to determine interest rates and the adequacy of security is not in itself an indication that the grantor has power to borrow the corpus or income without adequate interest or security.

(3) The circumstance that the grantor has directly or indirectly borrowed the corpus or income of the trust and has not completely repaid the loan, including any interest, before the begin-

ning of the taxable year. The preceding sentence does not apply to a loan which provides for adequate interest and adequate security, if it is made by a trustee other than the grantor or a related or subordinate trustee subservient to the grantor. See section 672(c) for definition of "a related or subordinate party".

(4) The existence of certain powers of administration exercisable in a nonfiduciary capacity by any nonadverse party without the approval or consent of any person in a fiduciary capacity. The term *powers of administration* means one or more of the following powers:

(i) A power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are significant from the viewpoint of voting control;

(ii) A power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; or

(iii) A power to reacquire the trust corpus by substituting other property of an equivalent value.

If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. This presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries. If a power is not exercisable by a person as trustee, the determination of whether the power is exercisable in a fiduciary or a nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration.

(c) *Authority of trustee.* The mere fact that a power exercisable by a trustee is described in broad language does not indicate that the trustee is authorized to purchase, exchange, or otherwise

deal with or dispose of the trust property or income for less than an adequate and full consideration in money or money's worth, or is authorized to lend the trust property or income to the grantor without adequate interest. On the other hand, such authority may be indicated by the actual administration of the trust.

**§ 1.676(a)-1 Power to revest title to portion of trust property in grantor; general rule.**

If a power to revest in the grantor title to any portion of a trust is exercisable by the grantor or a nonadverse party, or both, without the approval or consent of an adverse party, the grantor is treated as the owner of that portion, except as provided in section 676(b) (relating to powers affecting beneficial enjoyment of income only after the expiration of certain periods of time). If the title to a portion of the trust will revest in the grantor upon the exercise of a power by the grantor or a nonadverse party, or both, the grantor is treated as the owner of that portion regardless of whether the power is a power to revoke, to terminate, to alter or amend, or to appoint. See section 671 and §§ 1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit when a person is treated as the owner of all or only a portion of a trust.

**§ 1.676(b)-1 Powers exercisable only after a period of time.**

Section 676(b) provides an exception to the general rule of section 676(a) when the exercise of a power can only affect the beneficial enjoyment of the income of a trust received after the expiration of a period of time which is such that a grantor would not be treated as the owner of that portion, except as power were a reversionary interest. See §§ 1.673(a)-1 and 1.673(b)-1. Thus, for example, a grantor is excepted from the general rule of section 676(a) with respect to ordinary income if exercise of a power to revest corpus in him cannot affect the beneficial enjoyment of the income received within 10 years after the date of transfer of that portion of the trust. It is immaterial for this purpose that the power is vested at the time of the transfer. However, the

grantor is subject to the general rule of section 676(a) after the expiration of the period unless the power is relinquished. Thus, in the above example, the grantor may be treated as the owner and be taxed on all income in the eleventh and succeeding years if exercise of the power can affect beneficial enjoyment of income received in those years. If the beginning of the period during which the grantor may revest is postponed, the rules set forth in § 1.673(d)-1 are applicable to determine whether the grantor should be treated as an owner during the period following the postponement.

**§ 1.677(a)-1 Income for benefit of grantor; general rule.**

(a)(1) *Scope.* Section 677 deals with the treatment of the grantor of a trust as the owner of a portion of the trust because he has retained an interest in the income from that portion. For convenience, "grantor" and "spouse" are generally referred to in the masculine and feminine genders, respectively, but if the grantor is a woman the reference to "grantor" is to her and the reference to "spouse" is to her husband. Section 677 also deals with the treatment of the grantor of a trust as the owner of a portion of the trust because the income from property transferred in trust after October 9, 1969, is, or may be, distributed to his spouse or applied to the payment of premiums on policies of insurance on the life of his spouse. However, section 677 does not apply when the income of a trust is taxable to a grantor's spouse under section 71 (relating to alimony and separate maintenance payments) or section 682 (relating to income of an estate or trust in case of divorce, etc.). See section 671-1(b).

(2) *Cross references.* See section 671 and §§ 1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit when a person is treated as the owner of all or a portion of a trust.

(b) *Income for benefit of grantor or his spouse; general rule—(1) Property transferred in trust prior to October 10, 1969.* With respect to property transferred in trust prior to October 10, 1969, the grantor is treated, under section 677, in any taxable year as the owner (whether

or not he is treated as an owner under section 674) of a portion of a trust of which the income for the taxable year or for a period not within the exception described in paragraph (e) of this section is, or in the discretion of the grantor or a nonadverse party, or both (without the approval or consent of any adverse party) may be:

- (i) Distributed to the grantor;
- (ii) Held or accumulated for future distribution to the grantor; or
- (iii) Applied to the payment of premiums on policies of insurance on the life of the grantor, except policies of insurance irrevocably payable for a charitable purpose specified in section 170(c).

(2) *Property transferred in trust after October 9, 1969.* With respect to property transferred in trust after October 9, 1969, the grantor is treated, under section 677, in any taxable year as the owner (whether or not he is treated as an owner under section 674) of a portion of a trust of which the income for the taxable year or for a period not within the exception described in paragraph (e) of this section is, or in the discretion of the grantor, or his spouse, or a nonadverse party, or any combination thereof (without the approval or consent of any adverse party other than the grantor's spouse) may be:

- (i) Distributed to the grantor or the grantor's spouse;
- (ii) Held or accumulated for future distribution to the grantor or the grantor's spouse; or
- (iii) Applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, except policies of insurance irrevocably payable for a charitable purpose specified in section 170(c).

With respect to the treatment of a grantor as the owner of a portion of a trust solely because its income is, or may be, distributed or held or accumulated for future distribution to a beneficiary who is his spouse or applied to the payment of premiums for insurance on the spouse's life, section 677(a) applies to the income of a trust solely during the period of the marriage of the grantor to a beneficiary. In the case of divorce or separation, see sections 71 and 682 and the regulations thereunder.

(c) *Constructive distribution; cessation of interest.* Under section 677 the grantor is treated as the owner of a portion of a trust if he has retained any interest which might, without the approval or consent of an adverse party, enable him to have the income from that portion distributed to him at some time either actually or constructively (subject to the exception described in paragraph (e) of this section). In the case of a transfer in trust after October 9, 1969, the grantor is also treated as the owner of a portion of a trust if he has granted or retained any interest which might, without the approval or consent of an adverse party (other than the grantor's spouse), enable his spouse to have the income from the portion at some time, whether or not within the grantor's lifetime, distributed to the spouse either actually or constructively. See paragraph (b)(2) of this section for additional rules relating to the income of a trust prior to the grantor's marriage to a beneficiary. Constructive distribution to the grantor or to his spouse includes payment on behalf of the grantor or his spouse to another in obedience to his or her direction and payment of premiums upon policies of insurance on the grantor's, or his spouse's, life (other than policies of insurance irrevocably payable for charitable purposes specified in section 170(c)). If the grantor (in the case of property transferred prior to Oct. 10, 1969) or the grantor and his spouse (in the case of property transferred after Oct. 9, 1969) are divested permanently and completely of every interest described in this paragraph, the grantor is not treated as an owner under section 677 after that divesting. The word "interest" as used in this paragraph does not include the possibility that the grantor or his spouse might receive back from a beneficiary an interest in a trust by inheritance. Further, with respect to transfers in trust prior to October 10, 1969, the word "interest" does not include the possibility that the grantor might receive back from a beneficiary an interest in a trust as a surviving spouse under a statutory right of election or a similar right.

(d) *Discharge of legal obligation of grantor or his spouse.* Under section 677 a grantor is, in general, treated as the

owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor (or his spouse in the case of property transferred in trust by the grantor after October 9, 1969). However, see § 1.677(b)-1 for special rules for trusts whose income may not be applied for the discharge of any legal obligation of the grantor or the grantor's spouse other than the support or maintenance of a beneficiary (other than the grantor's spouse) whom the grantor or grantor's spouse is legally obligated to support. See § 301.7701-4(e) of this chapter for rules on the classification of and application of section 677 to an environmental remediation trust.

(e) *Exception for certain discretionary rights affecting income.* The last sentence of section 677(a) provides that a grantor shall not be treated as the owner when a discretionary right can only affect the beneficial enjoyment of the income of a trust received after a period of time during which a grantor would not be treated as an owner under section 673 if the power were a reversionary interest. See §§ 1.673(a)-1 and 1.673(b)-1. For example, if the ordinary income of a trust is payable to B for 10 years and then in the grantor's discretion income or corpus may be paid to B or to the grantor (or his spouse in the case of property transferred in trust by the grantor after October 9, 1969), the grantor is not treated as an owner with respect to the ordinary income under section 677 during the first 10 years. He will be treated as an owner under section 677 after the expiration of the 10-year period unless the power is relinquished. If the beginning of the period during which the grantor may substitute beneficiaries is postponed, the rules set forth in § 1.673(d)-1 are applicable in determining whether the grantor should be treated as an owner during the period following the postponement.

(f) *Accumulation of income.* If income is accumulated in any taxable year for future distribution to the grantor (or his spouse in the case of property transferred in trust by the grantor after Oct. 9, 1969), section 677(a)(2) treats the grantor as an owner for that

taxable year. The exception set forth in the last sentence of section 677(a) does not apply merely because the grantor (or his spouse in the case of property transferred in trust by the grantor after Oct. 9, 1969) must await the expiration of a period of time before he or she can receive or exercise discretion over previously accumulated income of the trust, even though the period is such that the grantor would not be treated as an owner under section 673 if a reversionary interest were involved. Thus, if income (including capital gains) of a trust is to be accumulated for 10 years and then will be, or at the discretion of the grantor, or his spouse in the case of property transferred in trust after October 9, 1969, or a nonadverse party, may be, distributed to the grantor (or his spouse in the case of property transferred in trust after Oct. 9, 1969), the grantor is treated as the owner of the trust from its inception. If income attributable to transfers after October 9, 1969 is accumulated in any taxable year during the grantor's lifetime for future distribution to his spouse, section 677(a)(2) treats the grantor as an owner for that taxable year even though his spouse may not receive or exercise discretion over such income prior to the grantor's death.

(g) *Examples.* The application of section 677(a) may be illustrated by the following examples:

*Example 1.* G creates an irrevocable trust which provides that the ordinary income is to be payable to him for life and that on his death the corpus shall be distributed to B, an unrelated person. Except for the right to receive income, G retains no right or power which would cause him to be treated as an owner under sections 671 through 677. Under the applicable local law capital gains must be applied to corpus. During the taxable year 1970 the trust has the following items of gross income and deductions:

Dividends .....	\$5,000
Capital gain .....	1,000
Expenses allocable to income.....	200
Expenses allocable to corpus.....	100

Since G has a right to receive income he is treated as an owner of a portion of the trust under section 677. Accordingly, he should include the \$5,000 of dividends, \$200 income expense, and \$100 corpus expense in the computation of his taxable income for 1970. He should not include the \$1,000 capital gain since that is not attributable to the portion of the trust that he owns. See § 1.671-3(b).

**Internal Revenue Service, Treasury**

**§ 1.677(b)-1**

The tax consequences of the capital gain are governed by the provisions of subparts A, B, C, and D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Had the trust sustained a capital loss in any amount the loss would likewise not be included in the computation of G's taxable income, but would also be governed by the provisions of such subparts.

*Example 2.* G creates a trust which provides that the ordinary income is payable to his adult son. Ten years and one day from the date of transfer or on the death of his son, whichever is earlier, corpus is to revert to G. In addition, G retains a discretionary right to receive \$5,000 of ordinary income each year. (Absent the exercise of this right all the ordinary income is to be distributed to his son.) G retained no other right or power which would cause him to be treated as an owner under subpart E (section 671 and following). Under the terms of the trust instrument and applicable local law capital gains must be applied to corpus. During the taxable year 1970 the trust had the following items of income and deductions:

Dividends .....	\$10,000
Capital gain .....	2,000
Expenses allocable to income .....	400
Expenses allocable to corpus .....	200

Since the capital gain is held or accumulated for future distributions to G, he is treated under section 677(a)(2) as an owner of a portion of the trust to which the gain is attributable. See §1.671-3(b).

Therefore, he must include the capital gain in the computation of his taxable income. (Had the trust sustained a capital loss in any amount, G would likewise include that loss in the computation of his taxable income.) In addition, because of G's discretionary right (whether exercised or not) he is treated as the owner of a portion of the trust which will permit a distribution of income to him of \$5,000. Accordingly, G includes dividends of \$5,208.33 and income expenses of \$208.33 in computing his taxable income, determined in the following manner:

Total dividends .....	\$10,000.00
Less: Expenses allocable to income .....	400.00
	<hr/>
Distributable income of the trust .....	9,600.00
	<hr/>
Portion of dividends attributable to G (5,000/9,600×\$10,000) .....	5,208.33
Portion of income expenses attributable to G (5,000/9,600×\$400) .....	208.33
	<hr/>
Amount of income subject to discretionary right .....	5,000.00

In accordance with §1.671-3(c), G also takes into account \$104.17 (5,000/9,600×\$200) of corpus expenses in computing his tax liability. The portion of the dividends and expenses of

the trust not attributable to G are governed by the provisions of subparts A through D.

[T.D. 7148, 36 FR 20749, Oct. 29, 1971, as amended by T.D. 8668, 61 FR 19191, May 1, 1996]

**§ 1.677(b)-1 Trusts for support.**

(a) Section 677(b) provides that a grantor is not treated as the owner of a trust merely because its income may in the discretion of any person other than the grantor (except when he is acting as trustee or cotrustee) be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse in the case of income from property transferred in trust after October 9, 1969), such as the child of the grantor, whom the grantor or his spouse is legally obligated to support. If income of the current year of the trust is actually so applied or distributed the grantor may be treated as the owner of any portion of the trust under section 677 to that extent, even though it might have been applied or distributed for other purposes. In the case of property transferred to a trust before October 10, 1969, for the benefit of the grantor's spouse, the grantor may be treated as the owner to the extent income of the current year is actually applied for the support or maintenance of his spouse.

(b) If any amount applied or distributed for the support of a beneficiary, including the grantor's spouse in the case of property transferred in trust before October 10, 1969, whom the grantor is legally obligated to support is paid out of corpus or out of income other than income of the current year, the grantor is treated as a beneficiary of the trust, and the amount applied or distributed is considered to be an amount paid within the meaning of section 661(a)(2), taxable to the grantor under section 662. Thus, he is subject to the other relevant portions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Accordingly, the grantor may be taxed on an accumulation distribution or a capital gain distribution under subpart D (section 665 and following) of such part I. Those provisions are applied on the basis that the grantor is the beneficiary.

**§ 1.678(a)-1**

**26 CFR Ch. I (4-1-12 Edition)**

(c) For the purpose of determining the items of income, deduction, and credit of a trust to be included under this section in computing the grantor's tax liability, the income of the trust for the taxable year of distribution will be deemed to have been first distributed. For example, in the case of a trust reporting on the calendar year basis, a distribution made on January 1, 1956, will be deemed to have been made out of ordinary income of the trust for the calendar year 1956 to the extent of the income for that year even though the trust had received no income as of January 1, 1956. Thus, if a distribution of \$10,000 is made on January 1, 1956, for the support of the grantor's dependent, the grantor will be treated as the owner of the trust for 1956 to that extent. If the trust received dividends of \$5,000 and incurred expenses of \$1,000 during that year but subsequent to January 1, he will take into account dividends of \$5,000 and expenses of \$1,000 in computing his tax liability for 1956. In addition, the grantor will be treated as a beneficiary of the trust with respect to the \$6,000 (\$10,000 less distributable income of \$4,000 (dividends of \$5,000 less expenses of \$1,000)) paid out of corpus or out of other than income of the current year. See paragraph (b) of this section.

(d) The exception provided in section 677(b) relates solely to the satisfaction of the grantor's legal obligation to support or maintain a beneficiary. Consequently, the general rule of section 677(a) is applicable when in the discretion of the grantor or nonadverse parties income of a trust may be applied in discharge of a grantor's obligations other than his obligation of support or maintenance falling within section 677(b). Thus, if the grantor creates a trust the income of which may in the discretion of a nonadverse party be applied in the payment of the grantor's debts, such as the payment of his rent or other household expenses, he is treated as an owner of the trust regardless of whether the income is actually so applied.

(e) The general rule of section 677(a), and not section 677(b), is applicable if discretion to apply or distribute income of a trust rests solely in the grantor, or in the grantor in conjunc-

tion with other persons, unless in either case the grantor has such discretion as trustee or cotrustee.

(f) The general rule of section 677(a), and not section 677(b), is applicable to the extent that income is required, without any discretionary determination, to be applied to the support of a beneficiary whom the grantor is legally obligated to support.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7148, 36 FR 20750, Oct. 29, 1971]

**§ 1.678(a)-1 Person other than grantor treated as substantial owner; general rule.**

(a) Where a person other than the grantor of a trust has a power exercisable solely by himself to vest the corpus or the income of any portion of a testamentary or inter vivos trust in himself, he is treated under section 678(a) as the owner of that portion, except as provided in section 678(b) (involving taxation of the grantor) and section 678(c) (involving and obligation of support). The holder of such a power also is treated as an owner of the trust even though he has partially released or otherwise modified the power so that he can no longer vest the corpus or income in himself, if he has retained such control of the trust as would, if retained by a grantor, subject the grantor to treatment as the owner under sections 671 to 677, inclusive. See section 671 and §§ 1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit where a person is treated as the owner of all or only a portion of a trust.

(b) Section 678(a) treats a person as an owner of a trust if he has a power exercisable solely by himself to apply the income or corpus for the satisfaction of his legal obligations, other than an obligation to support a dependent (see § 1.678(c)-1 subject to the limitation of section 678(b)). Section 678 does not apply if the power is not exercisable solely by himself. However, see § 1.662(a)-4 for principles applicable to income of a trust which, pursuant to the terms of the trust instrument, is used to satisfy the obligations of a person other than the grantor.

**§ 1.678(b)-1 If grantor is treated as the owner.**

Section 678(a) does not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is treated as the owner under sections 671 to 677, inclusive.

**§ 1.678(c)-1 Trusts for support.**

(a) Section 678(a) does not apply to a power which enables the holder, in the capacity of trustee or cotrustee, to apply the income of the trust to the support or maintenance of a person whom the holder is obligated to support, except to the extent the income is so applied. See paragraphs (a), (b), and (c) of § 1.677(b)-1 for applicable principles where any amount is applied for the support or maintenance of a person whom the holder is obligated to support.

(b) The general rule in section 678(a) (and not the exception in section 678(c)) is applicable in any case in which the holder of a power exercisable solely by himself is able, in any capacity other than that of trustee or cotrustee, to apply the income in discharge of his obligation of support or maintenance.

(c) Section 678(c) is concerned with the taxability of income subject to a power described in section 678(a). It has no application to the taxability of income which is either required to be applied pursuant to the terms of the trust instrument or is applied pursuant to a power which is not described in section 678(a), the taxability of such income being governed by other provisions of the Code. See § 1.662(a)-4.

**§ 1.678(d)-1 Renunciation of power.**

Section 678(a) does not apply to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence.

**§ 1.679-0 Outline of major topics.**

This section lists the major paragraphs contained in §§ 1.679-1 through 1.679-7 as follows:

*§ 1.679-1 U.S. transferor treated as owner of foreign trust.*

- (a) In general.

- (b) Interaction with sections 673 through 678.

- (c) Definitions.
  - (1) U.S. transferor.
  - (2) U.S. person.
  - (3) Foreign trust.
  - (4) Property.
  - (5) Related person.
  - (6) Obligation.
- (d) Examples.

*§ 1.679-2 Trusts treated as having a U.S. beneficiary.*

- (a) Existence of U.S. beneficiary.
  - (1) In general.
  - (2) Benefit to a U.S. person
    - (i) In general.
    - (ii) Certain unexpected beneficiaries.
    - (iii) Examples.
  - (3) Changes in beneficiary's status.
    - (i) In general.
    - (ii) Examples.
    - (4) General rules.
      - (i) Records and documents.
      - (ii) Additional factors.
      - (iii) Examples.
    - (b) Indirect U.S. beneficiaries.
      - (1) Certain foreign entities.
      - (2) Other indirect beneficiaries.
      - (3) Examples.
    - (c) Treatment of U.S. transferor upon foreign trust's acquisition or loss of U.S. beneficiary.
      - (1) Trusts acquiring a U.S. beneficiary.
      - (2) Trusts ceasing to have a U.S. beneficiary.
      - (3) Examples.

*§ 1.679-3 Transfers.*

- (a) In general.
- (b) Transfers by certain trusts.
  - (1) In general.
  - (2) Example.
  - (c) Indirect transfers.
    - (1) Principal purpose of tax avoidance.
    - (2) Principal purpose of tax avoidance deemed to exist.
    - (3) Effect of disregarding intermediary.
      - (i) In general.
      - (ii) Special rule.
      - (iii) Effect on intermediary.
    - (4) Related parties.
    - (5) Examples.
    - (d) Constructive transfers.
      - (1) In general.
      - (2) Examples.
      - (e) Guarantee of trust obligations.
        - (1) In general.
        - (2) Amount transferred.
        - (3) Principal repayments.
        - (4) Guarantee.
        - (5) Examples.
      - (f) Transfers to entities owned by a foreign trust.
        - (1) General rule.

§ 1.679-1

(2) Examples.

§ 1.679-4 Exceptions to general rule.

- (a) In general.
- (b) Transfers for fair market value.
  - (1) In general.
  - (2) Special rule.
  - (i) Transfers for partial consideration.
  - (ii) Example.
- (c) Certain obligations not taken into account.
  - (d) Qualified obligations.
    - (1) In general.
    - (2) Additional loans.
    - (3) Obligations that cease to be qualified.
    - (4) Transfers resulting from failed qualified obligations.
  - (5) Renegotiated loans.
  - (6) Principal repayments.
  - (7) Examples.

§ 1.679-5 Pre-immigration trusts.

- (a) In general.
- (b) Special rules.
  - (1) Change in grantor trust status.
  - (2) Treatment of undistributed income.
- (c) Examples.

§ 1.679-6 Outbound migrations of domestic trusts.

- (a) In general.
- (b) Amount deemed transferred.
- (c) Example.

§ 1.679-7 Effective dates.

- (a) In general.
- (b) Special rules.

[T.D. 8955, 66 FR 37889, July 20, 2001]

§ 1.679-1 U.S. transferor treated as owner of foreign trust.

(a) *In general.* A U.S. transferor who transfers property to a foreign trust is treated as the owner of the portion of the trust attributable to the property transferred if there is a U.S. beneficiary of any portion of the trust, unless an exception in § 1.679-4 applies to the transfer.

(b) *Interaction with sections 673 through 678.* The rules of this section apply without regard to whether the U.S. transferor retains any power or interest described in sections 673 through 677. If a U.S. transferor would be treated as the owner of a portion of a foreign trust pursuant to the rules of this section and another person would be treated as the owner of the same portion of the trust pursuant to section 678, then the U.S. transferor is treated

as the owner and the other person is not treated as the owner.

(c) *Definitions.* The following definitions apply for purposes of this section and §§ 1.679-2 through 1.679-7:

(1) *U.S. transferor.* The term *U.S. transferor* means any U.S. person who makes a transfer (as defined in § 1.679-3) of property to a foreign trust.

(2) *U.S. person.* The term *U.S. person* means a United States person as defined in section 7701(a)(30), a non-resident alien individual who elects under section 6013(g) to be treated as a resident of the United States, and an individual who is a dual resident taxpayer within the meaning of § 301.7701(b)-7(a) of this chapter.

(3) *Foreign trust.* Section 7701(a)(31)(B) defines the term *foreign trust*. See also § 301.7701-7 of this chapter.

(4) *Property.* The term *property* means any property including cash.

(5) *Related person.* A person is a *related person* if, without regard to the transfer at issue, the person is—

(i) A grantor of any portion of the trust (within the meaning of § 1.671-2(e)(1));

(ii) An owner of any portion of the trust under sections 671 through 679;

(iii) A beneficiary of the trust; or

(iv) A person who is related (within the meaning of section 643(i)(2)(B)) to any grantor, owner or beneficiary of the trust.

(6) *Obligation.* The term *obligation* means any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness, and, to the extent not previously described, any annuity contract.

(d) *Examples.* The following examples illustrate the rules of paragraph (a) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s father, who is a resident alien, *D* is *A*'s uncle, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Interaction with section 678.* *A* creates and funds *FT*. *FT* may provide for the education of *B* by paying for books, tuition, room and board. In addition, *C* has the power to vest the trust corpus or income in himself within the meaning of section 678(a)(1). Under paragraph (b) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred to *FT*

by *A* and *C* is not treated as the owner thereof.

*Example 2. U.S. person treated as owner of a portion of FT.* *D* creates and funds *FT* for the benefit of *B*. *D* retains a power described in section 676 and § 1.672(f)-3(a)(1). *A* transfers property to *FT*. Under sections 676 and 672(f), *D* is treated as the owner of the portion of *FT* attributable to the property transferred by *D*. Under paragraph (a) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred by *A*.

[T.D. 8955, 66 FR 37889, July 20, 2001]

### § 1.679-2 Trusts treated as having a U.S. beneficiary.

(a) *Existence of U.S. beneficiary*—(1) *In general.* The determination of whether a foreign trust has a U.S. beneficiary is made on an annual basis. A foreign trust is treated as having a U.S. beneficiary unless during the taxable year of the U.S. transferor—

(i) No part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, directly or indirectly, a U.S. person; and

(ii) If the trust is terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of, directly or indirectly, a U.S. person.

(2) *Benefit to a U.S. person*—(i) *In general.* For purposes of paragraph (a)(1) of this section, income or corpus may be paid or accumulated to or for the benefit of a U.S. person during a taxable year of the U.S. transferor if during that year, directly or indirectly, income may be distributed to, or accumulated for the benefit of, a U.S. person, or corpus may be distributed to, or held for the future benefit of, a U.S. person. This determination is made without regard to whether income or corpus is actually distributed to a U.S. person during that year, and without regard to whether a U.S. person's interest in the trust income or corpus is contingent on a future event.

(ii) *Certain unexpected beneficiaries.* Notwithstanding paragraph (a)(2)(i) of this section, for purposes of paragraph (a)(1) of this section, a person who is not named as a beneficiary and is not a member of a class of beneficiaries as defined under the trust instrument is not taken into consideration if the U.S. transferor demonstrates to the satisfaction of the Commissioner that the

person's contingent interest in the trust is so remote as to be negligible. The preceding sentence does not apply with respect to persons to whom distributions could be made pursuant to a grant of discretion to the trustee or any other person. A class of beneficiaries generally does not include heirs who will benefit from the trust under the laws of intestate succession in the event that the named beneficiaries (or members of the named class) have all deceased (whether or not stated as a named class in the trust instrument).

(iii) *Examples.* The following examples illustrate the rules of paragraphs (a)(1) and (2) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Distribution of income to U.S. person.* *A* transfers property to *FT*. The trust instrument provides that all trust income is to be distributed currently to *B*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 2. Income accumulation for the benefit of a U.S. person.* In 2001, *A* transfers property to *FT*. The trust instrument provides that from 2001 through 2010, the trustee of *FT* may distribute trust income to *C* or may accumulate the trust income. The trust instrument further provides that in 2011, the trust will terminate and the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust assets must be distributed to *C*. Because it is possible that income may be accumulated in each year, and that the accumulated income ultimately may be distributed to *B*, a U.S. person, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through 2011. This result applies even though no U.S. person may receive distributions from the trust during the tax years 2001 through 2010.

*Example 3. Corpus held for the benefit of a U.S. person.* The facts are the same as in Example 2, except that from 2001 through 2011, all trust income must be distributed to *C*. In 2011, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust corpus must be distributed to *C*. Because during each of *A*'s tax years from 2001 through 2011 trust corpus is held for possible future distribution to *B*, a U.S. person,

under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of those years. This result applies even though no U.S. person may receive distributions from the trust during the tax years 2001 through 2010.

*Example 4. Distribution upon U.S. transferor's death.* *A* transfers property to *FT*. The trust instrument provides that all trust income must be distributed currently to *C* and, upon *A*'s death, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*. Because *B* may receive a distribution of corpus upon the termination of *FT*, and *FT* could terminate in any year, *FT* is treated as having a U.S. beneficiary in the year of the transfer and in subsequent years.

*Example 5. Distribution after U.S. transferor's death.* The facts are the same as in *Example 4*, except the trust instrument provides that the trust will not terminate until the year following *A*'s death. Upon termination, the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. All trust assets are invested in the stock of *X*, a foreign corporation, and *X* makes no distributions to *FT*. Although no U.S. person may receive a distribution until the year after *A*'s death, and *FT* has no realized income during any year of its existence, during each year in which *A* is living corpus may be held for future distribution to *B*, a U.S. person. Thus, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through the year of *A*'s death.

*Example 6. Constructive benefit to U.S. person.* *A* transfers property to *FT*. The trust instrument provides that no income or corpus may be paid directly to a U.S. person. However, the trust instrument provides that trust corpus may be used to satisfy *B*'s legal obligations to a third party by making a payment directly to the third party. Under paragraphs (a)(1) and (2) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 7. U.S. person with negligible contingent interest.* *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *C*, and upon *C*'s death, all corpus is to be distributed to whomever of *C*'s three children is then living. All of *C*'s children are nonresident aliens. Under the laws of intestate succession that would apply to *FT*, if all of *C*'s children are deceased at the time of *C*'s death, the corpus would be distributed to *A*'s heirs. *A*'s living relatives at the time of the transfer consist solely of two brothers and two nieces, all of whom are nonresident aliens, and two first cousins, one of whom, *E*, is a U.S. citizen. Although it is possible under certain circumstances that *E* could receive a corpus distribution under the applicable laws of intestate succession, for each year the trust is in existence *A* is able to demonstrate

to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that *E*'s contingent interest in *FT* is so remote as to be negligible. Provided that paragraph (a)(4) of this section does not require a different result, *FT* is not treated as having a U.S. beneficiary.

*Example 8. U.S. person with non-negligible contingent interest.* *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. Under the laws of intestate succession that would apply to *FT*, *B* and *C* would share equally in the trust corpus if *D* is not living at the time of *A*'s death. *A* is unable to demonstrate to the satisfaction of the Commissioner that *B*'s contingent interest in the trust is so remote as to be negligible. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

*Example 9. U.S. person as member of class of beneficiaries.* *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. If *D* is not then living, the corpus is to be distributed to *D*'s descendants. *D*'s grandson, *E*, is a resident alien. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

*Example 10. Trustee's discretion in choosing beneficiaries.* *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of, any person who is pursuing the academic study of ancient Greek, in the trustee's discretion. Because it is possible that a U.S. person will receive distributions of income or corpus, or will have income accumulated for his benefit, *FT* is treated as having a U.S. beneficiary. This result applies even if, during a tax year, no distributions or accumulations are actually made to or for the benefit of a U.S. person. *A* may not invoke paragraph (a)(2)(ii) of this section because a U.S. person could benefit pursuant to a grant of discretion in the trust instrument.

*Example 11. Appointment of remainder beneficiary.* *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute current income to *C*, or may accumulate income, and, upon termination of the trust, trust assets are to be distributed to *C*. However, the trust instrument further provides that *D*, *A*'s uncle, may appoint a different remainder beneficiary. Because it is possible that a U.S. person could be named as the remainder beneficiary, and because corpus could be held in each year for the future benefit of that U.S. person, *FT* is treated as having a U.S. beneficiary for each year.

*Example 12. Trust not treated as having a U.S. beneficiary.* A transfers property to FT. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of C. Upon termination of the trust, all income and corpus must be distributed to C. Assume that paragraph (a)(4) of this section is not applicable under the facts and circumstances and that A establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Because no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, either directly or indirectly, a U.S. person, and if the trust is terminated no part of the income or corpus of the trust could be paid to or for the benefit of, either directly or indirectly, a U.S. person, FT is not treated as having a U.S. beneficiary.

*Example 13. U.S. beneficiary becomes non-U.S. person.* In 2001, A transfers property to FT. The trust instrument provides that, as long as B remains a U.S. resident, no distributions of income or corpus may be made from the trust to B. The trust instrument further provides that if B becomes a nonresident alien, distributions of income (including previously accumulated income) and corpus may be made to him. If B remains a U.S. resident at the time of FT's termination, all accumulated income and corpus is to be distributed to C. In 2007, B becomes a nonresident alien and remains so thereafter. Because income may be accumulated during the years 2001 through 2007 for the benefit of a person who is a U.S. person during those years, FT is treated as having a U.S. beneficiary under paragraph (a)(1) of this section during each of those years. This result applies even though B cannot receive distributions from FT during the years he is a resident alien and even though B might remain a resident alien who is not entitled to any distribution from FT. Provided that paragraph (a)(4) of this section does not require a different result and that A establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no other U.S. persons are reasonably expected to benefit from the trust, FT is not treated as having a U.S. beneficiary under paragraph (a)(1) of this section during tax years after 2007.

(3) *Changes in beneficiary's status*—(i) *In general.* For purposes of paragraph (a)(1) of this section, the possibility that a person that is not a U.S. person could become a U.S. person will not cause that person to be treated as a U.S. person for purposes of paragraph (a)(1) of this section until the tax year of the U.S. transferor in which that individual actually becomes a U.S. per-

son. However, if a person who is not a U.S. person becomes a U.S. person for the first time more than 5 years after the date of a transfer to the foreign trust by a U.S. transferor, that person is not treated as a U.S. person for purposes of applying paragraph (a)(1) of this section with respect to that transfer.

(ii) *Examples.* The following examples illustrate the rules of paragraph (a)(3) of this section. In these examples, A is a resident alien, B is A's son, who is a resident alien, C is A's daughter, who is a nonresident alien, and FT is a foreign trust. The examples are as follows:

*Example 1. Non-U.S. beneficiary becomes U.S. person.* In 2001, A transfers property to FT. The trust instrument provides that all income is to be distributed currently to C and that, upon the termination of FT, all corpus is to be distributed to C. Assume that paragraph (a)(4) of this section is not applicable under the facts and circumstances and that A establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Under paragraph (a)(3)(i) of this section, FT is not treated as having a U.S. beneficiary during the tax years of A in which C remains a nonresident alien. If C first becomes a resident alien in 2004, FT is treated as having a U.S. beneficiary commencing in that year under paragraph (a)(3) of this section. See paragraph (c) of this section regarding the treatment of A upon FT's acquisition of a U.S. beneficiary.

*Example 2. Non-U.S. beneficiary becomes U.S. person more than 5 years after transfer.* The facts are the same as in *Example 1*, except C first becomes a resident alien in 2007. FT is treated as not having a U.S. beneficiary under paragraph (a)(3)(i) of this section with respect to the property transfer by A. However, if C had previously been a U.S. person during any prior period, the 5-year exception in paragraph (a)(3)(i) of this section would not apply in 2007 because it would not have been the first time C became a U.S. person.

(4) *General rules*—(i) *Records and documents.* Even if, based on the terms of the trust instrument, a foreign trust is not treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the trust may nevertheless be treated as having a U.S. beneficiary pursuant to paragraph (a)(1) of this section based on the following—

(A) All written and oral agreements and understandings relating to the trust;

(B) Memoranda or letters of wishes;

(C) All records that relate to the actual distribution of income and corpus; and

(D) All other documents that relate to the trust, whether or not of any purported legal effect.

(ii) *Additional factors.* For purposes of determining whether a foreign trust is treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the following additional factors are taken into account—

(A) If the terms of the trust instrument allow the trust to be amended to benefit a U.S. person, all potential benefits that could be provided to a U.S. person pursuant to an amendment must be taken into account;

(B) If the terms of the trust instrument do not allow the trust to be amended to benefit a U.S. person, but the law applicable to a foreign trust may require payments or accumulations of income or corpus to or for the benefit of a U.S. person (by judicial reformation or otherwise), all potential benefits that could be provided to a U.S. person pursuant to the law must be taken into account, unless the U.S. transferor demonstrates to the satisfaction of the Commissioner that the law is not reasonably expected to be applied or invoked under the facts and circumstances; and

(C) If the parties to the trust ignore the terms of the trust instrument, or if it is reasonably expected that they will do so, all benefits that have been, or are reasonably expected to be, provided to a U.S. person must be taken into account.

(iii) *Examples.* The following examples illustrate the rules of paragraph (a)(4) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Amendment pursuant to local law.* *A* creates and funds *FT* for the benefit of *C*. The terms of *FT* (which, according to the trust instrument, cannot be amended) provide that no part of the income or corpus of *FT* may be paid or accumulated during the

taxable year to or for the benefit of any U.S. person, either during the existence of *FT* or at the time of its termination. However, pursuant to the applicable foreign law, *FT* can be amended to provide for additional beneficiaries, and there is an oral understanding between *A* and the trustee that *B* can be added as a beneficiary. Under paragraphs (a)(1) and (a)(4)(ii)(B) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 2. Actions in violation of the terms of the trust.* *A* transfers property to *FT*. The trust instrument provides that no U.S. person can receive income or corpus from *FT* during the term of the trust or at the termination of *FT*. Notwithstanding the terms of the trust instrument, a letter of wishes directs the trustee of *FT* to provide for the educational needs of *B*, who is about to begin college. The letter of wishes contains a disclaimer to the effect that its contents are only suggestions and recommendations and that the trustee is at all times bound by the terms of the trust as set forth in the trust instrument. Under paragraphs (a)(1) and (a)(4)(ii)(C) of this section, *FT* is treated as having a U.S. beneficiary.

(b) *Indirect U.S. beneficiaries—(1) Certain foreign entities.* For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of—

(i) A controlled foreign corporation, as defined in section 957(a);

(ii) A foreign partnership, if a U.S. person is a partner of such partnership; or

(iii) A foreign trust or estate, if such trust or estate has a U.S. beneficiary (within the meaning of paragraph (a)(1) of this section).

(2) *Other indirect beneficiaries.* For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of a U.S. person through an intermediary, such as an agent or nominee, or by any other means where a U.S. person may obtain an actual or constructive benefit.

(3) *Examples.* The following examples illustrate the rules of this paragraph (b). Unless otherwise noted, *A* is a resident alien. *B* is *A*'s son and is a resident alien. *FT* is a foreign trust. The examples are as follows:

*Example 1. Trust benefitting foreign corporation.* A transfers property to *FT*. The beneficiary of *FT* is *FC*, a foreign corporation. *FC* has outstanding solely 100 shares of common stock. *B* owns 49 shares of the *FC* stock and *FC2*, also a foreign corporation, owns the remaining 51 shares. *FC2* has outstanding solely 100 shares of common stock. *B* owns 49 shares of *FC2* and nonresident alien individuals own the remaining 51 *FC2* shares. *FC* is a controlled foreign corporation (as defined in section 957(a), after the application of section 958(a)(2)). Under paragraphs (a)(1) and (b)(1)(i) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 2. Trust benefitting another trust.* A transfers property to *FT*. The terms of *FT* permit current distributions of income to *B*. A transfers property to another foreign trust, *FT2*. The terms of *FT2* provide that no U.S. person can benefit either as to income or corpus, but permit current distributions of income to *FT*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary and, under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT2* is treated as having a U.S. beneficiary.

*Example 3. Trust benefitting another trust after transferor's death.* A transfers property to *FT*. The terms of *FT* require that all income from *FT* be accumulated during A's lifetime. In the year following A's death, a share of *FT* is to be distributed to *FT2*, another foreign trust, for the benefit of *B*. Under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT* is treated as having a U.S. beneficiary beginning with the year of A's transfer of property to *FT*.

*Example 4. Indirect benefit through use of debit card.* A transfers property to *FT*. The trust instrument provides that no U.S. person can benefit either as to income or corpus. However, *FT* maintains an account with *FB*, a foreign bank, and *FB* issues a debit card to *B* against the account maintained by *FT* and *B* is allowed to make withdrawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 5. Other indirect benefit.* A transfers property to *FT*. *FT* is administered by *FTC*, a foreign trust company. *FTC* forms *IBC*, an international business corporation formed under the laws of a foreign jurisdiction. *IBC* is the beneficiary of *FT*. *IBC* maintains an account with *FB*, a foreign bank. *FB* issues a debit card to *B* against the account maintained by *IBC* and *B* is allowed to make withdrawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

(c) *Treatment of U.S. transferor upon foreign trust's acquisition or loss of U.S. beneficiary*—(1) *Trusts acquiring a U.S. beneficiary.* If a foreign trust to which a U.S. transferor has transferred prop-

erty is not treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) for any taxable year of the U.S. transferor, but the trust is treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) in any subsequent taxable year, the U.S. transferor is treated as having additional income in the first such taxable year of the U.S. transferor in which the trust is treated as having a U.S. beneficiary. The amount of the additional income is equal to the trust's undistributed net income, as defined in section 665(a), at the end of the U.S. transferor's immediately preceding taxable year and is subject to the rules of section 668, providing for an interest charge on accumulation distributions from foreign trusts.

(2) *Trusts ceasing to have a U.S. beneficiary.* If, for any taxable year of a U.S. transferor, a foreign trust that has received a transfer of property from the U.S. transferor ceases to be treated as having a U.S. beneficiary, the U.S. transferor ceases to be treated as the owner of the portion of the trust attributable to the transfer beginning in the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary (unless the U.S. transferor is treated as an owner thereof pursuant to sections 673 through 677). The U.S. transferor is treated as making a transfer of property to the foreign trust on the first day of the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary. The amount of the property deemed to be transferred to the trust is the portion of the trust attributable to the prior transfer to which paragraph (a)(1) of this section applied. For rules regarding the recognition of gain on transfers to foreign trusts, see section 684.

(3) *Examples.* The rules of this paragraph (c) are illustrated by the following examples. *A* is a resident alien, *B* is *A*'s son, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Trust acquiring U.S. beneficiary.*  
(i) In 2001, *A* transfers stock with a fair market value of \$100,000 to *FT*. The stock has an adjusted basis of \$50,000 at the time of the

transfer. The trust instrument provides that income may be paid currently to, or accumulated for the benefit of, *B* and that, upon the termination of the trust, all income and corpus is to be distributed to *B*. At the time of the transfer, *B* is a nonresident alien. *A* is not treated as the owner of any portion of *FT* under sections 673 through 677. *FT* accumulates a total of \$30,000 of income during the taxable years 2001 through 2003. In 2004, *B* moves to the United States and becomes a resident alien. Assume paragraph (a)(4) of this section is not applicable under the facts and circumstances.

(i) Under paragraph (c)(1) of this section, *A* is treated as receiving an accumulation distribution in the amount of \$30,000 in 2004 and immediately transferring that amount back to the trust. The accumulation distribution is subject to the rules of section 668, providing for an interest charge on accumulation distributions.

(iii) Under paragraphs (a)(1) and (3) of this section, beginning in 2005, *A* is treated as the owner of the portion of *FT* attributable to the stock transferred by *A* to *FT* in 2001 (which includes the portion attributable to the accumulated income deemed to be retransferred in 2004).

*Example 2. Trust ceasing to have U.S. beneficiary.* (i) The facts are the same as in *Example 1*. In 2008, *B* becomes a nonresident alien. On the date *B* becomes a nonresident alien, the stock transferred by *A* to *FT* in 2001 has a fair market value of \$125,000 and an adjusted basis of \$50,000.

(ii) Under paragraph (c)(2) of this section, beginning in 2009, *FT* is not treated as having a U.S. beneficiary, and *A* is not treated as the owner of the portion of the trust attributable to the prior transfer of stock. For rules regarding the recognition of gain on the termination of ownership status, see section 684.

[T.D. 8955, 66 FR 37889, July 20, 2001]

**§ 1.679-3 Transfers.**

(a) *In general.* A transfer means a direct, indirect, or constructive transfer.

(b) *Transfers by certain trusts—(1) In general.* If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Example.* The following example illustrates this paragraph (b):

*Example.* In 2001, *A*, a U.S. citizen, creates and funds *DT*, a domestic trust. *A* has the power to revest absolutely in himself the title to the property in *DT* and is treated as the owner of *DT* pursuant to section 676. In 2004, *DT* transfers property to *FT*, a foreign

trust. *A* is treated as having transferred the property to *FT* in 2004 for purposes of this section.

(c) *Indirect transfers—(1) Principal purpose of tax avoidance.* A transfer to a foreign trust by any person (intermediary) to whom a U.S. person transfers property is treated as an indirect transfer by a U.S. person to the foreign trust if such transfer is made pursuant to a plan one of the principal purposes of which is the avoidance of United States tax.

(2) *Principal purpose of tax avoidance deemed to exist.* For purposes of paragraph (c)(1) of this section, a transfer is deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of United States tax if—

(i) The U.S. person is related (within the meaning of paragraph (c)(4) of this section) to a beneficiary of the foreign trust, or has another relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the U.S. transferor would make a transfer to the foreign trust; and

(ii) The U.S. person cannot demonstrate to the satisfaction of the Commissioner that—

(A) The intermediary has a relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the intermediary would make a transfer to the foreign trust;

(B) The intermediary acted independently of the U.S. person;

(C) The intermediary is not an agent of the U.S. person under generally applicable United States agency principles; and

(D) The intermediary timely complied with the reporting requirements of section 6048, if applicable.

(3) *Effect of disregarding intermediary—*

(i) *In general.* Except as provided in paragraph (c)(3)(ii) of this section, if a transfer is treated as an indirect transfer pursuant to paragraph (c)(1) of this section, then the intermediary is treated as an agent of the U.S. person, and the property is treated as transferred to the foreign trust by the U.S. person in the year the property is transferred, or made available, by the intermediary to the foreign trust. The fair market

value of the property transferred is determined as of the date of the transfer by the intermediary to the foreign trust.

(ii) *Special rule.* If the Commissioner determines, or if the taxpayer can demonstrate to the satisfaction of the Commissioner, that the intermediary is an agent of the foreign trust under generally applicable United States agency principles, the property will be treated as transferred to the foreign trust in the year the U.S. person transfers the property to the intermediary. The fair market value of the property transferred will be determined as of the date of the transfer by the U.S. person to the intermediary.

(iii) *Effect on intermediary.* If a transfer of property is treated as an indirect transfer under paragraph (c)(1) of this section, the intermediary is not treated as having transferred the property to the foreign trust.

(4) *Related parties.* For purposes of this paragraph (c), a U.S. transferor is treated as related to a U.S. beneficiary of a foreign trust if the U.S. transferor and the beneficiary are related for purposes of section 643(i)(2)(B), with the following modifications—

(i) For purposes of applying section 267 (other than section 267(f)) and section 707(b)(1), “at least 10 percent” is used instead of “more than 50 percent” each place it appears; and

(ii) The principles of section 267(b)(10), using “at least 10 percent” instead of “more than 50 percent,” apply to determine whether two corporations are related.

(5) *Examples.* The rules of this paragraph (c) are illustrated by the following examples:

*Example 1. Principal purpose of tax avoidance.* A, a U.S. citizen, creates and funds FT, a foreign trust, for the benefit of A’s children, who are U.S. citizens. In 2004, A decides to transfer an additional 1000X to the foreign trust. Pursuant to a plan with a principal purpose of avoiding the application of section 679, A transfers 1000X to I, a foreign person. I subsequently transfers 1000X to FT. Under paragraph (c)(1) of this section, A is treated as having made a transfer of 1000X to FT.

*Example 2. U.S. person unable to demonstrate that intermediary acted independently.* A, a U.S. citizen, creates and funds FT, a foreign trust, for the benefit of A’s children, who are U.S. citizens. On July 1, 2004, A transfers

XYZ stock to D, A’s uncle, who is a non-resident alien. D immediately sells the XYZ stock and uses the proceeds to purchase ABC stock. On January 1, 2007, D transfers the ABC stock to FT. A is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that D acted independently of A in making the transfer to FT. Under paragraph (c)(1) of this section, A is treated as having transferred the ABC stock to FT. Under paragraph (c)(3) of this section, D is treated as an agent of A, and the transfer is deemed to have been made on January 1, 2007.

*Example 3. Indirect loan to foreign trust.* A, a U.S. citizen, previously created and funded FT, a foreign trust, for the benefit of A’s children, who are U.S. citizens. On July 1, 2004, A deposits 500X with FB, a foreign bank. On January 1, 2005, FB loans 450X to FT. A is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that FB has a relationship with FT that establishes a reasonable basis for concluding that FB would make a loan to FT or that FB acted independently of A in making the loan. Under paragraph (c)(1) of this section, A is deemed to have transferred 450X directly to FT on January 1, 2005. Under paragraph (c)(3) of this section, FB is treated as an agent of A. For possible exceptions with respect to qualified obligations of the trust, and the treatment of principal repayments with respect to obligations of the trust that are not qualified obligations, see § 1.679-4.

*Example 4. Loan to foreign trust prior to deposit of funds in foreign bank.* The facts are the same as in Example 3, except that A makes the 500X deposit with FB on January 2, 2005, the day after FB makes the loan to FT. The result is the same as in Example 3.

(d) *Constructive transfers—(1) In general.* For purposes of paragraph (a) of this section, a constructive transfer includes any assumption or satisfaction of a foreign trust’s obligation to a third party.

(2) *Examples.* The rules of this paragraph (d) are illustrated by the following examples. In each example, A is a U.S. citizen and FT is a foreign trust. The examples are as follows:

*Example 1. Payment of debt of foreign trust.* FT owes 1000X to Y, an unrelated foreign corporation, for the performance of services by Y for FT. In satisfaction of FT’s liability to Y, A transfers to Y property with a fair market value of 1000X. Under paragraph (d)(1) of this section, A is treated as having made a constructive transfer of the property to FT.

*Example 2. Assumption of liability of foreign trust.* FT owes 1000X to Y, an unrelated foreign corporation, for the performance of

services by Y for FT. A assumes FT's liability to pay Y. Under paragraph (d)(1) of this section, A is treated as having made a constructive transfer of property with a fair market value of 1000X to FT.

(e) *Guarantee of trust obligations*—(1) *In general.* If a foreign trust borrows money or other property from any person who is not a related person (within the meaning of § 1.679-1(c)(5)) with respect to the trust (lender) and a U.S. person (U.S. guarantor) that is a related person with respect to the trust guarantees (within the meaning of paragraph (e)(4) of this section) the foreign trust's obligation, the U.S. guarantor is treated for purposes of this section as a U.S. transferor that has made a transfer to the trust on the date of the guarantee in an amount determined under paragraph (e)(2) of this section. To the extent this paragraph causes the U.S. guarantor to be treated as having made a transfer to the trust, a lender that is a U.S. person shall not be treated as having transferred that amount to the foreign trust.

(2) *Amount transferred.* The amount deemed transferred by a U.S. guarantor described in paragraph (e)(1) of this section is the guaranteed portion of the adjusted issue price of the obligation (within the meaning of § 1.1275-1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of § 1.1273-1(c)).

(3) *Principal repayments.* If a U.S. person is treated under this paragraph (e) as having made a transfer by reason of the guarantee of an obligation, payments of principal to the lender by the foreign trust with respect to the obligation are taken into account on and after the date of the payment in determining the portion of the trust attributable to the property deemed transferred by the U.S. guarantor.

(4) *Guarantee.* For purposes of this section, the term guarantee—

(i) Includes any arrangement under which a person, directly or indirectly, assures, on a conditional or unconditional basis, the payment of another's obligation;

(ii) Encompasses any form of credit support, and includes a commitment to make a capital contribution to the debtor or otherwise maintain its financial viability; and

(iii) Includes an arrangement reflected in a comfort letter, regardless of whether the arrangement gives rise to a legally enforceable obligation. If an arrangement is contingent upon the occurrence of an event, in determining whether the arrangement is a guarantee, it is assumed that the event has occurred.

(5) *Examples.* The rules of this paragraph (e) are illustrated by the following examples. In all of the examples, A is a U.S. resident and FT is a foreign trust. The examples are as follows:

*Example 1. Foreign lender.* X, a foreign corporation, loans 1000X of cash to FT in exchange for FT's obligation to repay the loan. A guarantees the repayment of 600X of FT's obligation. Under paragraph (e)(2) of this section, A is treated as having transferred 600X to FT.

*Example 2. Unrelated U.S. lender.* The facts are the same as in *Example 1*, except X is a U.S. person that is not a related person within the meaning of § 1.679-1(c)(5). The result is the same as in *Example 1*.

(f) *Transfers to entities owned by a foreign trust*—(1) *General rule.* If a U.S. person is a related person (as defined in § 1.679-1(c)(5)) with respect to a foreign trust, any transfer of property by the U.S. person to an entity in which the foreign trust holds an ownership interest is treated as a transfer of such property by the U.S. person to the foreign trust followed by a transfer of the property from the foreign trust to the entity owned by the foreign trust, unless the U.S. person demonstrates to the satisfaction of the Commissioner that the transfer to the entity is properly attributable to the U.S. person's ownership interest in the entity.

(2) *Examples.* The rules of this paragraph (f) are illustrated by the following examples. In all of the examples, A is a U.S. citizen, FT is a foreign trust, and FC is a foreign corporation. The examples are as follows:

*Example 1. Transfer treated as transfer to trust.* A creates and funds FT, which is treated as having a U.S. beneficiary under § 1.679-2. FT owns all of the outstanding stock of FC. A transfers property directly to FC. Because FT is the sole shareholder of FC, A is unable to demonstrate to the satisfaction of the Commissioner that the transfer is properly attributable to A's ownership interest in FC. Accordingly, under this paragraph (f), A

is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. Under §1.679-1(a), *A* is treated as the owner of the portion of *FT* attributable to the property treated as transferred directly to *FT*. Under §1.367(a)-1T(c)(4)(ii), the transfer of property by *FT* to *FC* is treated as a transfer of the property by *A* to *FC*.

*Example 2. Transfer treated as transfer to trust.* The facts are the same as in *Example 1*, except that *FT* is not treated as having a U.S. beneficiary under §1.679-2. Under this paragraph (f), *A* is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. *A* is not treated as the owner of *FT* for purposes of §1.679-1(a). For rules regarding the recognition of gain on the transfer, see section 684.

*Example 3. Transfer not treated as transfer to trust.* *A* creates and funds *FT*. *FC* has outstanding solely 100 shares of common stock. *FT* owns 50 shares of *FC* stock, and *A* owns the remaining 50 shares. On July 1, 2001, *FT* and *A* each transfer 1000X to *FC*. *A* is able to demonstrate to the satisfaction of the Commissioner that *A*'s transfer to *FC* is properly attributable to *A*'s ownership interest in *FC*. Accordingly, under this paragraph (f), *A*'s transfer to *FC* is not treated as a transfer to *FT*.

[T.D. 8955, 66 FR 37889, July 20, 2001]

#### § 1.679-4 Exceptions to general rule.

(a) *In general.* Section 1.679-1 does not apply to—

(1) Any transfer of property to a foreign trust by reason of the death of the transferor;

(2) Any transfer of property to a foreign trust described in sections 402(b), 404(a)(4), or 404A;

(3) Any transfer of property to a foreign trust described in section 501(c)(3) (without regard to the requirements of section 508(a)); and

(4) Any transfer of property to a foreign trust to the extent the transfer is for fair market value.

(b) *Transfers for fair market value—(1) In general.* For purposes of this section, a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust. For example, rents, royalties, interest, and compensation paid to a trust are transfers for fair market value only to the extent that the payments reflect an arm's length price for the use of the

property of, or for the services rendered by, the trust. For purposes of this determination, an interest in the trust is not property received from the trust. For purposes of this section, a distribution to a trust with respect to an interest held by such trust in an entity other than a trust or an interest in certain investment trusts described in §301.7701-4(c) of this chapter, liquidating trusts described in §301.7701-4(d) of this chapter, or environmental remediation trusts described in §301.7701-4(e) of this chapter is considered to be a transfer for fair market value.

(2) *Special rule—(i) Transfers for partial consideration.* For purposes of this section, if a person transfers property to a foreign trust in exchange for property having a fair market value that is less than the fair market value of the property transferred, the exception in paragraph (a)(4) of this section applies only to the extent of the fair market value of the property received.

(ii) *Example.* This paragraph (b) is illustrated by the following example:

*Example.* *A*, a U.S. citizen, transfers property that has a fair market value of 1000X to *FT*, a foreign trust, in exchange for 600X of cash. Under this paragraph (b), §1.679-1 applies with respect to the transfer of 400X (1000X less 600X) to *FT*.

(c) *Certain obligations not taken into account.* Solely for purposes of this section, in determining whether a transfer by a U.S. transferor that is a related person (as defined in §1.679-1(c)(5)) with respect to the foreign trust is for fair market value, any obligation (as defined in §1.679-1(c)(6)) of the trust or a related trust described in §1.679-1(c)(5) that is not a qualified obligation within the meaning of paragraph (d)(1) of this section shall not be taken into account.

(d) *Qualified obligations—(1) In general.* For purposes of this section, an obligation is treated as a qualified obligation only if—

(i) The obligation is reduced to writing by an express written agreement;

(ii) The term of the obligation does not exceed five years (for purposes of determining the term of an obligation, the obligation's maturity date is the last possible date that the obligation can be outstanding under the terms of the obligation);

(iii) All payments on the obligation are denominated in U.S. dollars;

(iv) The yield to maturity is not less than 100 percent of the applicable Federal rate and not greater than 130 percent of the applicable Federal rate (the applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter));

(v) The U.S. transferor extends the period for assessment of any income or transfer tax attributable to the transfer and any consequential income tax changes for each year that the obligation is outstanding, to a date not earlier than three years after the maturity date of the obligation (this extension is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. transferor's taxable year for the year of the transfer and is paid within such period); when properly executed and filed, such an agreement is deemed to be consented to for purposes of § 301.6501(c)-1(d) of this chapter; and

(vi) The U.S. transferor reports the status of the loan, including principal and interest payments, on Form 3520 for every year that the loan is outstanding.

(2) *Additional loans.* If, while the original obligation is outstanding, the U.S. transferor or a person related to the trust (within the meaning of § 1.679-1(c)(5)) directly or indirectly obtains another obligation issued by the trust, or if the U.S. transferor directly or indirectly obtains another obligation issued by a person related to the trust, the original obligation is deemed to have the maturity date of any such subsequent obligation in determining whether the term of the original obligation exceeds the specified 5-year term. In addition, a series of obligations issued and repaid by the trust (or a person related to the trust) is treated as a single obligation if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of this provision.

(3) *Obligations that cease to be qualified.* If an obligation treated as a quali-

fied obligation subsequently fails to be a qualified obligation (e.g., renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. transferor is treated as making a transfer to the trust in an amount equal to the original obligation's adjusted issue price (within the meaning of § 1.1275-1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of § 1.1273-1(c)) as of the date of the subsequent event that causes the obligation to no longer be a qualified obligation. If the maturity date is extended beyond five years by reason of the issuance of a subsequent obligation by the trust (or person related to the trust), the amount of the transfer will not exceed the issue price of the subsequent obligation. The subsequent obligation is separately tested to determine if it is a qualified obligation.

(4) *Transfers resulting from failed qualified obligations.* In general, a transfer resulting from a failed qualified obligation is deemed to occur on the date of the subsequent event that causes the obligation to no longer be a qualified obligation. However, based on all of the facts and circumstances, the Commissioner may deem a transfer to have occurred on any date on or after the issue date of the original obligation. For example, if at the time the original obligation was issued, the transferor knew or had reason to know that the obligation would not be repaid, the Commissioner could deem the transfer to have occurred on the issue date of the original obligation.

(5) *Renegotiated loans.* Any loan that is renegotiated, extended, or revised is treated as a new loan, and any transfer of funds to a foreign trust after such renegotiation, extension, or revision under a pre-existing loan agreement is treated as a transfer subject to this section.

(6) *Principal repayments.* The payment of principal with respect to any obligation that is not treated as a qualified obligation under this paragraph is taken into account on and after the date of the payment in determining the portion of the trust attributable to the property transferred.

(7) *Examples.* The rules of this paragraph (d) are illustrated by the following examples. In the examples, *A* and *B* are U.S. residents and *FT* is a foreign trust. The examples are as follows:

*Example 1. Demand loan.* *A* transfers 500X to *FT* in exchange for a demand note that permits *A* to require repayment by *FT* at any time. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full 500X transfer to *FT*.

*Example 2. Private annuity.* *A* transfers 4000X to *FT* in exchange for an annuity from the foreign trust that will pay *A* 100X per year for the rest of *A*'s life. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full 4000X transfer to *FT*.

*Example 3. Loan to unrelated foreign trust.* *B* transfers 1000X to *FT* in exchange for an obligation of the trust. The term of the obligation is fifteen years. *B* is not a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because *B* is not a related person, the fair market value of the obligation received by *B* is taken into account for purposes of determining whether *B*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section, even though the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section.

*Example 4. Transfer for an obligation with term in excess of 5 years.* *A* transfers property that has a fair market value of 5000X to *FT* in exchange for an obligation of the trust. The term of the obligation is ten years. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because the term of the obligation is greater than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is

eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full 5000X transfer to *FT*.

*Example 5. Transfer for a qualified obligation.* The facts are the same as in *Example 4*, except that the term of the obligation is 3 years. Assuming the other requirements of paragraph (d)(1) of this section are satisfied, the obligation is a qualified obligation and its adjusted issue price is taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section.

*Example 6. Effect of subsequent obligation on original obligation.* *A* transfers property that has a fair market value of 1000X to *FT* in exchange for an obligation that satisfies the requirements of paragraph (d)(1) of this section. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Two years later, *A* transfers an additional 2000X to *FT* and receives another obligation from *FT* that has a maturity date four years from the date that the second obligation was issued. Under paragraph (d)(2) of this section, the original obligation is deemed to have the maturity date of the second obligation. Under paragraph (a) of this section, *A* is treated as having made a transfer in an amount equal to the original obligation's adjusted issue price (within the meaning of §1.1275-1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273-1(c)) as of the date of issuance of the second obligation. The second obligation is tested separately to determine whether it is a qualified obligation for purposes of applying paragraph (a) of this section to the second transfer.

[T.D. 8955, 66 FR 37889, July 20, 2001]

### § 1.679-5 Pre-immigration trusts.

(a) *In general.* If a nonresident alien individual becomes a U.S. person and the individual has a residency starting date (as determined under section 7701(b)(2)(A)) within 5 years after directly or indirectly transferring property to a foreign trust (the original transfer), the individual is treated as having transferred to the trust on the residency starting date an amount equal to the portion of the trust attributable to the property transferred by the individual in the original transfer.

(b) *Special rules—(1) Change in grantor trust status.* For purposes of paragraph (a) of this section, if a nonresident alien individual who is treated as owning any portion of a trust under the provisions of subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, subsequently ceases to

## § 1.679-6

be so treated, the individual is treated as having made the original transfer to the foreign trust immediately before the trust ceases to be treated as owned by the individual.

(2) *Treatment of undistributed income.* For purposes of paragraph (a) of this section, the property deemed transferred to the foreign trust on the residency starting date includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred. Undistributed net income for periods before the individual's residency starting date is taken into account only for purposes of determining the amount of the property deemed transferred.

(c) *Examples.* The rules of this section are illustrated by the following examples:

*Example 1. Nonresident alien becomes resident alien.* On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. On January 1, 2006, *A* becomes a resident of the United States within the meaning of section 7701(b)(1)(A) and has a residency starting date of January 1, 2006, within the meaning of section 7701(b)(2)(A). Under paragraph (a) of this section, *A* is treated as a U.S. transferor and is deemed to transfer the property to *FT* on January 1, 2006. Under paragraph (b)(2) of this section, the property deemed transferred to *FT* on January 1, 2006, includes the undistributed net income of the trust, as defined in section 665(a), attributable to the property originally transferred.

*Example 2. Nonresident alien loses power to revest property.* On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. *A* has the power to revest absolutely in himself the title to such property transferred and is treated as the owner of the trust pursuant to sections 676 and 672(f). On January 1, 2008, the terms of *FT* are amended to remove *A*'s power to revest in himself title to the property transferred, and *A* ceases to be treated as the owner of *FT*. On January 1, 2010, *A* becomes a resident of the United States. Under paragraph (b)(1) of this section, for purposes of paragraph (a) of this section *A* is treated as having originally transferred the property to *FT* on January 1, 2008. Because this date is within five years of *A*'s residency starting date, *A* is deemed to have made a transfer to the foreign trust on January 1, 2010, his residency starting date. Under paragraph (b)(2) of this section, the property deemed transferred to the foreign trust on January 1, 2010, includes the undistributed net income of the

## 26 CFR Ch. I (4-1-12 Edition)

trust, as defined in section 665(a), attributable to the property deemed transferred.

[T.D. 8955, 66 FR 37889, July 20, 2001]

### § 1.679-6 Outbound migrations of domestic trusts.

(a) *In general.* Subject to the provisions of paragraph (b) of this section, if an individual who is a U.S. person transfers property to a trust that is not a foreign trust, and such trust becomes a foreign trust while the U.S. person is alive, the U.S. individual is treated as a U.S. transferor and is deemed to transfer the property to a foreign trust on the date the domestic trust becomes a foreign trust.

(b) *Amount deemed transferred.* For purposes of paragraph (a) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property previously transferred. Undistributed net income for periods prior to the migration is taken into account only for purposes of determining the portion of the trust that is attributable to the property transferred by the U.S. person.

(c) *Example.* The following example illustrates the rules of this section. For purposes of the example, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, and *DT* is a domestic trust. The example is as follows:

*Example. Outbound migration of domestic trust.* On January 1, 2002, *A* transfers property to *DT*, for the benefit of *B*. On January 1, 2003, *DT* acquires a foreign trustee who has the power to determine whether and when distributions will be made to *B*. Under section 7701(a)(30)(E) and § 301.7701-7(d)(ii)(A) of this chapter, *DT* becomes a foreign trust on January 1, 2003. Under paragraph (a) of this section, *A* is treated as transferring property to a foreign trust on January 1, 2003. Under paragraph (b) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred.

[T.D. 8955, 66 FR 37889, July 20, 2001]

### § 1.679-7 Effective dates.

(a) *In general.* Except as provided in paragraph (b) of this section, the rules of §§ 1.679-1, 1.679-2, 1.679-3, and 1.679-4

apply with respect to transfers after August 7, 2000.

(b) *Special rules.* (1) The rules of §1.679-4(c) and (d) apply to an obligation issued after February 6, 1995, whether or not in accordance with a pre-existing arrangement or understanding. For purposes of the rules of §1.679-4(c) and (d), if an obligation issued on or before February 6, 1995, is modified after that date, and the modification is a significant modification within the meaning of §1.1001-3, the obligation is treated as if it were issued on the date of the modification. However, the penalty provided in section 6677 applies only to a failure to report transfers in exchange for obligations issued after August 20, 1996.

(2) The rules of §1.679-5 apply to persons whose residency starting date is after August 7, 2000.

(3) The rules of §1.679-6 apply to trusts that become foreign trusts after August 7, 2000.

[T.D. 8955, 66 FR 37889, July 20, 2001]

#### MISCELLANEOUS

#### § 1.681(a)-1 Limitation on charitable contributions deductions of trusts; scope of section 681.

Under section 681, the unlimited charitable contributions deduction otherwise allowable to a trust under section 642(c) is, in general, subject to percentage limitations, corresponding to those applicable to contributions by an individual under section 170(b)(1) (A) and (B), under the following circumstances:

(a) To the extent that the deduction is allocable to “unrelated business income”;

(b) For taxable years beginning before January 1, 1970, if the trust has engaged in a prohibited transaction;

(c) For taxable years beginning before January 1, 1970, if income is accumulated for a charitable purpose and the accumulation is (1) unreasonable, (2) substantially diverted to a non-charitable purpose, or (3) invested against the interests of the charitable beneficiaries.

Further, if the circumstance set forth in paragraph (a) or (c) of this section is applicable, the deduction is limited to income actually paid out for charitable

purposes, and is not allowed for income only set aside or to be used for those purposes. If the circumstance set forth in paragraph (b) of this section is applicable, deductions for contributions to the trust may be disallowed. The provisions of section 681 are discussed in detail in §§1.681(a)-2 through 1.681(c)-1. For definition of the term “income”, see section 643(b) and §1.643(b)-1.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7428, 41 FR 34627, Aug. 16, 1976]

#### § 1.681(a)-2 Limitation on charitable contributions deduction of trusts with trade or business income.

(a) *In general.* No charitable contributions deduction is allowable to a trust under section 642(c) for any taxable year for amounts allocable to the trust's unrelated business income for the taxable year. For the purpose of section 681(a) the term *unrelated business income* of a trust means an amount which would be computed as the trust's unrelated business taxable income under section 512 and the regulations thereunder, if the trust were an organization exempt from tax under section 501(a) by reason of section 501(c)(3). For the purpose of the computation under section 512, the term *unrelated trade or business* includes a trade or business carried on by a partnership of which a trust is a member, as well as one carried on by the trust itself. While the charitable contributions deduction under section 642(c) is entirely disallowed by section 681(a) for amounts allocable to “unrelated business income”, a partial deduction is nevertheless allowed for such amounts by the operation of section 512(b)(11), as illustrated in paragraphs (b) and (c) of this section. This partial deduction is subject to the percentage limitations applicable to contributions by an individual under section 170(b)(1) (A) and (B), and is not allowed for amounts set aside or to be used for charitable purposes but not actually paid out during the taxable year. Charitable contributions deductions otherwise allowable under section 170, 545(b)(2), or 642(c) for contributions to a trust are not disallowed solely because the trust has unrelated business income.