

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.

(b) *Determination of amounts allocable to unrelated business income.* In determining the amount for which a charitable contributions deduction would otherwise be allowable under section 642(c) which are allocable to unrelated business income, and therefore not allowable as a deduction, the following steps are taken:

(1) There is first determined the 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), but without taking the charitable contributions deduction allowed under section 512(b)(11).

(2) The amount for which a charitable contributions deduction would otherwise be allowable under section 642(c) is then allocated between the amount determined in subparagraph (1) of this paragraph and any other income of the trust. Unless the facts clearly indicate to the contrary, the allocation to the amount determined in subparagraph (1) of this paragraph is made on the basis of the ratio (but not in excess of 100 percent) of the amount determined in subparagraph (1) of this paragraph to the taxable income of the trust, determined without the deduction for personal exemption under section 642(b), the charitable contributions deduction under section 642(c), or the deduction for distributions to beneficiaries under section 661(a).

(3) The amount for which a charitable contributions deduction would otherwise be allowable under section 642(c) which is allocable to unrelated business income as determined in subparagraph (2) of this paragraph, and therefore not allowable as a deduction, is the amount determined in subparagraph (2) of this paragraph reduced by the charitable contributions deduction which would be allowed under section 512(b)(11) if the trust were an organization exempt from tax under section 501(a) by reason of section 501(c)(3).

(c) *Examples.* (1) The application of this section may be illustrated by the following examples, in which it is assumed that the Y charity is not a charitable organization qualifying under

section 170(b)(1)(A) (see subparagraph (2) of this paragraph):

Example 1. The X trust has income of \$50,000. There is included in this amount a net profit of \$31,000 from the operation of a trade or business. The trustee is required to pay half of the trust income to A, an individual, and the balance of the trust income to the Y charity, an organization described in section 170(c)(2). The trustee pays each beneficiary \$25,000. Under these facts, the unrelated business income of the trust (computed before the charitable contributions deduction which would be allowed under section 512(b)(11)) is \$30,000 (\$31,000 less the deduction of \$1,000 allowed by section 512(b)(12)). The deduction otherwise allowable under section 642(c) is \$25,000, the amount paid to the Y charity. The portion allocable to the unrelated business income (computed as prescribed in paragraph (b)(2) of this section) is \$15,000, that is, an amount which bears the same ratio to \$25,000 as \$30,000 bears to \$50,000. The portion allocable to the unrelated business income, and therefore disallowed as a deduction, is \$15,000 reduced by \$6,000 (20 percent of \$30,000, the charitable contributions deduction which would be allowable under section 512(b)(11)), or \$9,000.

Example 2. Assume the same facts as in example 1, except that the trustee has discretion as to the portion of the trust income to be paid to each beneficiary, and the trustee pays \$40,000 to A and \$10,000 to the Y charity. The deduction otherwise allowable under section 642(c) is \$10,000. The portion allocable to the unrelated business income computed as prescribed in paragraph (b)(2) of this section is \$6,000, that is, an amount which bears the same ratio to \$10,000 as \$30,000 bears to \$50,000. Since this amount does not exceed the charitable contributions deduction which would be allowable under section 512(b)(11) (\$6,000, determined as in example 1), no portion of it is disallowed as a deduction.

Example 3. Assume the same facts as in example 1, except that the terms of the trust instrument require the trustee to pay to the Y charity the trust income, if any, derived from the trade or business, and to pay to A all the trust income derived from other sources. The trustee pays \$31,000 to the Y charity and \$19,000 to A. The deduction otherwise allowable under section 642(c) is \$31,000. Since the entire income from the trade or business is paid to Y charity, the amount allocable to the unrelated business income computed before the charitable contributions deduction under section 512(b)(11) is \$30,000 (\$31,000 less the deduction of \$1,000 allowed by section 512(b)(12)). The amount allocable to the unrelated business income and therefore disallowed as a deduction is \$24,000 (\$30,000 less \$6,000).

Example 4. (i) Under the terms of the trust, the trustee is required to pay half of the trust income to A, an individual, for his life, and the balance of the trust income to the Y charity, an organization described in section 170(c)(2). Capital gains are allocable to corpus and upon A's death the trust is to terminate and the corpus is to be distributed to the Y charity. The trust has taxable income of \$50,000 computed without any deduction for personal exemption, charitable contributions, or distributions. The amount of \$50,000 includes \$10,000 capital gains, \$30,000 (\$31,000 less the \$1,000 deduction allowed under section 512(b)(12)) unrelated business income (computed before the charitable contributions deduction which would be allowed under section 512(b)(11)) and other income of \$9,000. The trustee pays each beneficiary \$20,000.

(ii) The deduction otherwise allowable under section 642(c) is \$30,000 (\$20,000 paid to Y charity and \$10,000 capital gains allocated to corpus and permanently set aside for charitable purposes). The portion allocable to the unrelated business income is \$15,000, that is, an amount which bears the same ratio to \$20,000 (the amount paid to Y charity) as \$30,000 bears to \$40,000 (\$50,000 less \$10,000 capital gains allocable to corpus). The portion allocable to the unrelated business income, and therefore disallowed as a deduction, is \$15,000 reduced by \$6,000 (the charitable contributions deduction which would be allowable under section 512(b)(11)), or \$9,000.

(2) If, in the examples in subparagraph (1) of this paragraph, the Y charity were a charitable organization qualifying under section 170(b)(1)(A), then the deduction allowable under section 512(b)(11) would be computed at a rate of 30 percent.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 6605, 27 FR 8097, Aug. 15, 1962]

§ 1.681(b)-1 Cross reference.

For disallowance of certain charitable, etc., deductions otherwise allowable under section 642(c), see sections 508(d) and 4948(c)(4). See also 26 CFR 1.681(b)-1 and 1.681(c)-1 (rev. as of Apr. 1, 1974) for provisions applying before January 1, 1970.

[T.D. 7428, 41 FR 34627, Aug. 16, 1976]

§ 1.682(a)-1 Income of trust in case of divorce, etc.

(a) *In general.* (1) Section 682(a) provides rules in certain cases for determining the taxability of income of

trusts as between spouses who are divorced, or who are separated under a decree of separate maintenance or a written separation agreement. In such cases, the spouse actually entitled to receive payments from the trust is considered the beneficiary rather than the spouse in discharge of whose obligations the payments are made, except to the extent that the payments are specified to be for the support of the obligor spouse's minor children in the divorce or separate maintenance decree, the separation agreement or the governing trust instrument. For convenience, the beneficiary spouse will hereafter in this section and in § 1.682(b)-1 be referred to as the "wife" and the obligor spouse from whom she is divorced or legally separated as the "husband". (See section 7701(a)(17).) Thus, under section 682(a) income of a trust:

(i) Which is paid, credited, or required to be distributed to the wife in a taxable year of the wife, and

(ii) Which, except for the provisions of section 682, would be includible in the gross income of her husband,

is includible in her gross income and is not includible in his gross income.

(2) Section 682(a) does not apply in any case to which section 71 applies. Although section 682(a) and section 71 seemingly cover some of the same situations, there are important differences between them. Thus, section 682(a) applies, for example, to a trust created before the divorce or separation and not in contemplation of it, while section 71 applies only if the creation of the trust or payments by a previously created trust are in discharge of an obligation imposed upon or assumed by the husband (or made specific) under the court order or decree divorcing or legally separating the husband and wife, or a written instrument incident to the divorce status or legal separation status, or a written separation agreement. If section 71 applies, it requires inclusion in the wife's income of the full amount of periodic payments received attributable to property in trust (whether or not out of trust income), while, if section 71 does not apply, section 682(a) requires amounts paid, credited, or required to be distributed to her to be included only to the