

state statute will not constitute a recognition event for purposes of section 1001 and will not result in a taxable gift from the trust's grantor or any of the trust's beneficiaries. A switch to a method not specifically authorized by state statute, but valid under state law (including a switch via judicial decision or a binding non-judicial settlement) may constitute a recognition event to the trust or its beneficiaries for purposes of section 1001 and may result in taxable gifts from the trust's grantor and beneficiaries, based on the relevant facts and circumstances. In addition, an allocation to income of all or a part of the gains from the sale or exchange of trust assets will generally be respected if the allocation is made either pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of a discretionary power granted to the fiduciary by applicable local law or by the governing instrument, if not prohibited by applicable local law. This section is effective for taxable years of trusts and estates ending after January 2, 2004.

[T.D. 9102, 69 FR 19, Jan. 2, 2004]

**§ 1.643(b)-2 Dividends allocated to corpus.**

Extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law are not considered "income" for purposes of subpart A, B, C, or D, part I, subchapter J, chapter 1 of the Code. See section 643(a)(4), § 1.643(a)-4, § 1.643(d)-2, section 665(e), paragraph (b) of § 1.665(e)-1, and paragraph (b) of § 1.665(e)-1A for the treatment of such items in the computation of distributable net income.

[T.D. 7204, 37 FR 17134, Aug. 25, 1972]

**§ 1.643(c)-1 Definition of "beneficiary".**

An heir, legatee, or devisee (including an estate or trust) is a beneficiary. A trust created under a decedent's will is a beneficiary of the decedent's estate. The following persons are treated as beneficiaries:

(a) Any person with respect to an amount used to discharge or satisfy

that person's legal obligation as that term is used in § 1.662(a)-4.

(b) The grantor of a trust with respect to an amount applied or distributed for the support of a dependent under the circumstances specified in section 677(b) out of corpus or out of other than income for the taxable year of the trust.

(c) The trustee or cotrustee of a trust with respect to an amount applied or distributed for the support of a dependent under the circumstances specified in section 678(c) out of corpus or out of other than income for the taxable year of the trust.

**§ 1.643(d)-1 Definition of "foreign trust created by a United States person".**

(a) *In general.* For the purpose of part I, subchapter J, chapter 1 of the Internal Revenue Code, the term *foreign trust created by a United States person* means that portion of a foreign trust (as defined in section 7701(a)(31)) attributable to money or property (including all accumulated earnings, profits, or gains attributable to such money or property) of a U.S. person (as defined in section 7701(a)(30)) transferred directly or indirectly, or under the will of a decedent who at the date of his death was a U.S. citizen or resident, to the foreign trust. A foreign trust created by a person who is not a U.S. person, to which a U.S. person transfers his money or property, is a foreign trust created by a U.S. person to the extent that the fair market value of the entire foreign trust is attributable to money or property of the U.S. person transferred to the foreign trust. The transfer of money or property to the foreign trust may be made either directly or indirectly by a U.S. person. Transfers of money or property to a foreign trust do not include transfers of money or property pursuant to a sale or exchange which is made for a full and adequate consideration. Transfers to which section 643(d) and this section apply are transfers of money or property which establish or increase the corpus of a foreign trust. The rules set forth in this section with respect to transfers by a U.S. person to a foreign trust also are applicable with respect to transfers under the will of a decedent who at the date of his death was

a U.S. citizen or resident. For provisions relating to the information returns which are required to be filed with respect to the creation of or transfers to foreign trusts, see section 6048 and §16.3-1 of this chapter (Temporary Regulations under the Revenue Act of 1962).

(b) *Determination of a foreign trust created by a U.S. person*—(1) *Transfers of money or property only by a U.S. person.* If all the items of money or property constituting the corpus of a foreign trust are transferred to the trust by a U.S. person, the entire foreign trust is a foreign trust created by a U.S. person.

(2) *Transfers of money or property by both a U.S. person and a person other than a U.S. person; transfers required to be treated as separate funds.* Where there are transfers of money or property by both a U.S. person and a person other than a U.S. person to a foreign trust, and it is necessary, either by reason of the provisions of the governing instrument of the trust or by reason of some other requirement such as local law, that the trustee treat the entire foreign trust as composed of two separate funds, one consisting of the money or property (including all accumulated earnings, profits, or gains attributable to such money or property) transferred by the U.S. person and the other consisting of the money or property (including all accumulated earnings, profits, or gains attributable to such money or property) transferred by the person other than the U.S. person, the foreign trust created by a U.S. person shall be the fund consisting of the money or property transferred by the U.S. person. See example 1 in paragraph (c) of this section.

(3) *Transfers of money or property by both a U.S. person and a person other than a U.S. person; transfers not required to be treated as separate funds.* Where the corpus of a foreign trust consists of money or property transferred to the trust (simultaneously or at different times) by a U.S. person and by a person who is not a U.S. person, the foreign trust created by a U.S. person within the meaning of section 643(d) is that portion of the entire foreign trust which, immediately after any transfer of money or property to the trust, the

fair market value of money or property (including all accumulated earnings, profits, or gains attributable to such money or property) transferred to the foreign trust by the U.S. person bears to the fair market value of the corpus (including all accumulated earnings, profits, or gains attributable to the corpus) of the entire foreign trust.

(c) *Examples.* The provisions of paragraph (b) of this section may be illustrated by the following examples. Example 1 illustrates the application of paragraph (b)(2) of this section. Example (2) illustrates the application of paragraph (b)(3) of this section in a case where there is no provision in the governing instrument of the trust or elsewhere which would require the trustee to treat the corpus of the trust as composed of more than one fund.

*Example 1.* On January 1, 1964, the date of the creation of a foreign trust, a U.S. person transfers to it stock of a U.S. corporation with a fair market value of \$50,000. On the same day, a person other than a U.S. person transfers to the trust Country X bonds with a fair market value of \$25,000. The governing instrument of the trust provides that the income from the stock of the U.S. corporation is to be accumulated until A, a U.S. beneficiary, reaches the age of 21 years, and upon his reaching that age, the stock and income accumulated thereon are to be distributed to him. The governing instrument of the trust further provides that the income from the Country X bonds is to be accumulated until B, a U.S. beneficiary, reaches the age of 21 years, and upon his reaching that age, the bonds and income accumulated thereon are to be distributed to him. To comply with the provisions of the governing instrument of the trust that the income from the stock of the U.S. corporation be accumulated and distributed to A and that the income from the Country X bonds be accumulated and distributed to B, it is necessary that the trustee treat the transfers as two separate funds. The fund consisting of the stock of the U.S. corporation is a foreign trust created by a U.S. person.

*Example 2.* On January 1, 1964, the date of the creation of a foreign trust, a U.S. person transfers to it property having a fair market value of \$60,000 and a person other than a U.S. person transfers to it property having a fair market value of \$40,000. Immediately after these transfers, the foreign trust created by a U.S. person is 60 percent of the entire foreign trust, determined as follows:

$\$60,000$  (Value of property transferred by U.S. person) /  $\$100,000$  (Value of entire property transferred to trust) = 60 percent

**Internal Revenue Service, Treasury**

**§ 1.643(h)-1**

The undistributed net income for the calendar years 1964 and 1965 is \$20,000 which increases the value of the entire foreign trust to \$120,000 (\$100,000 plus \$20,000). Accordingly, as of December 31, 1965, the portion of the foreign trust created by the U.S. person is \$72,000 (60 percent of \$120,000). On January 1, 1966, the U.S. person transfers property having a fair market value of \$40,000 increasing the value of the entire foreign trust to \$160,000 (\$120,000 plus \$40,000) and increasing the value of the portion of the foreign trust created by the U.S. person to \$112,000 (\$72,000 plus \$40,000). Immediately, after this transfer, the foreign trust created by the U.S. person is 70 percent of the entire foreign trust, determined as follows:

\$112,000 (Value of property transferred by U.S. person)/\$160,000 (Value of entire property transferred to the trust)=70 percent

[T.D. 6989, 34 FR 732, Jan. 17, 1969]

**§ 1.643(d)-2 Illustration of the provisions of section 643.**

(a) The provisions of section 643 may be illustrated by the following example:

*Example.* (1) Under the terms of the trust instrument, the income of a trust is required to be currently distributed to W during her life. Capital gains are allocable to corpus and all expenses are charges against corpus. During the taxable year the trust has the following items of income and expenses:

Dividends from domestic corporations .....	\$30,000
Extraordinary dividends allocated to corpus by the trustee in good faith .....	20,000
Taxable interest .....	10,000
Tax-exempt interest .....	10,000
Long-term capital gains .....	10,000
Trustee's commissions and miscellaneous expenses allocable to corpus .....	5,000

(2) The "income" of the trust determined under section 643(b) which is currently distributable to W is \$50,000, consisting of dividends of \$30,000, taxable interest of \$10,000, and tax-exempt interest of \$10,000. The trustee's commissions and miscellaneous expenses allocable to tax-exempt interest amount to \$1,000 (10,000/50,000×\$5,000).

(3) The "distributable net income" determined under section 643(a) amounts to \$45,000, computed as follows:

Dividends from domestic corporations .....	\$30,000
Taxable interest .....	10,000
Nontaxable interest .....	\$10,000
Less: Expenses allocable thereto .....	1,000
	9,000
Total .....	49,000
Less: Expenses (\$5,000 less \$1,000 allocable to tax-exempt interest) .....	4,000
Distributable net income .....	45,000

In determining the distributable net income of \$45,000, the taxable income of the trust is computed with the following modifications: No deductions are allowed for distributions to W and for personal exemption of the trust (section 643(a) (1) and (2)); capital gains allocable to corpus are excluded and the deduction allowable under section 1202 is not taken into account (section 643(a)(3)); the extraordinary dividends allocated to corpus by the trustee in good faith are excluded (sections 643(a)(4)); and the tax-exempt interest (as adjusted for expenses) and the dividend exclusion of \$50 are included) section 643(a) (5) and (7)).

(b) See paragraph (c) of the example in §1.661(c)-2 for the computation of distributable net income where there is a charitable contributions deduction.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960. Redesignated, T.D. 6989, 34 FR 732, Jan. 1, 1969]

**§ 1.643(h)-1 Distributions by certain foreign trusts through intermediaries.**

(a) *In general*—(1) *Principal purpose of tax avoidance.* Except as provided in paragraph (b) of this section, for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code, and section 6048, any property (within the meaning of paragraph (f) of this section) that is transferred to a United States person by another person (an intermediary) who has received property from a foreign trust will be treated as property transferred directly by the foreign trust to the United States person if the intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of United States tax.

(2) *Principal purpose of tax avoidance deemed to exist.* For purposes of paragraph (a)(1) of this section, a transfer will be deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of United States tax if the United States person—

(i) Is related (within the meaning of paragraph (e) of this section) to a grantor of the foreign trust, or has another relationship with a grantor of the foreign trust that establishes a reasonable basis for concluding that the grantor of the foreign trust would make a gratuitous transfer (within the