

Internal Revenue Service, Treasury

§ 1.662(c)-4

§ 1.662(c)-4 Illustration of the provisions of sections 661 and 662.

The provisions of sections 661 and 662 may be illustrated in general by the following example:

Example. (a) Under the terms of a testamentary trust one-half of the trust income is to be distributed currently to W, the decedent's wife, for her life. The remaining trust income may, in the trustee's discretion, either be paid to D, the grantor's daughter, paid to designated charities, or accumulated. The trust is to terminate at the death of W and the principal will then be payable to D. No provision is made in the trust instrument with respect to depreciation of rental property. Capital gains are allocable to the principal account under the applicable local law. The trust and both beneficiaries file returns on the calendar year basis. The records of the fiduciary show the following items of income and deduction for the taxable year 1955:

Rents	\$50,000
Dividends of domestic corporations	50,000
Tax-exempt interest	20,000
Partially tax-exempt interest	10,000
Capital gains (long term)	20,000
Depreciation of rental property	10,000
Expenses attributable to rental income	15,400
Trustee's commissions allocable to income account	2,800

Trustee's commissions allocable to principal account	1,100
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(b) The income for trust accounting purposes is \$111,800, and the trustee distributes one-half (\$55,900) to W and in his discretion makes a contribution of one-quarter (\$27,950) to charity X and distributes the remaining one-quarter (\$27,950) to D. The total of the distributions to beneficiaries is \$83,850, consisting of (1) income required to be distributed currently to W of \$55,900 and (2) other amounts properly paid or credited to D of \$27,950. The income for trust accounting purposes of \$111,800 is determined as follows:

Rents	\$50,000
Dividends	50,000
Tax-exempt interest	20,000
Partially tax-exempt interest	10,000
Total	130,000
Less:	
Rental expenses	\$15,400
Trustee's commissions allocable to income account	2,800
	<u>18,200</u>
Income as computed under section 643(b)	111,800

(c) The distributable net income of the trust as computed under section 643(a) is \$82,750, determined as follows:

Rents	\$50,000
Dividends	50,000
Partially tax-exempt interest	10,000
Tax-exempt interest	\$20,000
Less:	
Trustee's commissions allocable thereto (20,000/130,000 of \$3,900)	\$600
Charitable contributions allocable thereto (20,000/130,000 of \$27,950)	4,300
	<u>4,900</u>
	15,100
Total	125,100
Deductions:	
Rental expenses	15,400
Trustee's commissions (\$3,900 less \$600 allocated to tax-exempt interest)	3,300
Charitable deduction (\$27,950 less \$4,300 attributable to tax-exempt interest) ..	23,650
	<u>42,350</u>
Distributable net income	82,750

In computing the distributable net income of \$82,750, the taxable income of the trust was computed with the following modifications: No deductions were allowed for distributions to beneficiaries and for personal exemption of the trust (section 643(a) (1) and (2)); capital gains were excluded and no deduction under section 1202 (relating to the 50 percent deduction for long-term capital gains) was taken into account (section 643(a)(3)); and the tax-exempt interest (as adjusted for expenses and charitable contributions) and the dividend exclusion of \$50 were included (section 643(a) (5) and (7)).

(d) Inasmuch as the distributable net income of \$82,750 as determined under section 643(a) is less than the sum of the amounts distributed to W and D of \$83,850, the deduction allowable to the trust under section 661(a) is such distributable net income as modified under section 661(c) to exclude therefrom the items of income not included in the gross income of the trust, as follows:

Distributable net income	\$82,750
Less:	
Tax-exempt interest (as adjusted for expenses and the charitable contributions)	\$15,100
Dividend exclusion allowable under section 116	50

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Deduction allowable under section 661(a)	67,600

(e) For the purpose of determining the character of the amounts deductible under section 642(c) and section 661(a), the trustee

elects to offset the trustee's commissions (other than the portion required to be allocated to tax-exempt interest) against the rental income. The following table shows the determination of the character of the amounts deemed distributed to beneficiaries and contributed to charity.

	Rents	Taxable dividends	Excluded dividends	Tax exempt interest	Partially tax exempt interest	Total
Trust income	\$50,000	\$49,950	\$50	\$20,000	\$10,000	\$130,000
Less:						
Charitable contribution	10,750	10,750		4,300	2,150	27,950
Rental expenses	15,400					15,400
Trustee's commissions	3,300			600		3,900
Total deductions	29,450	10,750	0	4,900	2,150	47,250
Amounts distributable to beneficiaries	20,550	39,200	50	15,100	7,850	82,750

The character of the charitable contribution is determined by multiplying the total charitable contribution (\$27,950) by a fraction consisting of each item of trust income, respectively, over the total trust income, except that no part of the dividends excluded from gross income are deemed included in the charitable contribution. For example, the charitable contribution is deemed to consist of rents of \$10,750 ($50,000/130,000 \times \$27,950$).

(f) The taxable income of the trust is \$9,900 determined as follows:

Rental income	\$50,000
Dividends (\$50,000 less \$50 exclusion)	49,950
Partially tax-exempt interest	10,000
Capital gains	20,000
Gross income	129,950
Deductions:	
Rental expenses	15,400
Trustee's commissions	3,300
Charitable contributions	23,650
Capital gain deduction	10,000
Distributions to beneficiaries	67,600
Personal exemption	100
	120,050
Taxable income	9,900

(g) In computing the amount includible in W's gross income under section 662(a)(1), the \$55,900 distribution to her is deemed to be composed of the following proportions of the items of income deemed to have been distributed to the beneficiaries by the trust (see paragraph (e) of this example):

Rents ($20,550/82,750 \times \$55,900$)	\$13,882
Dividends ($39,250/82,750 \times \$55,900$)	26,515
Partially tax-exempt interest ($7,850/82,750 \times \$55,900$)	5,303
Tax-exempt interest ($15,100/82,750 \times \$55,900$)	10,200
Total	55,900

Accordingly, W will exclude \$10,200 of tax-exempt interest from gross income and will receive the credits and exclusion for dividends received and for partially tax-exempt inter-

est provided in sections 34, 116, and 35, respectively, with respect to the dividends and partially tax-exempt interest deemed to have been distributed to her, her share of the dividends being aggregated with other dividends received by her for purposes of the dividend credit and exclusion. In addition, she may deduct a share of the depreciation deduction proportionate to the trust income allocable to her; that is, one-half of the total depreciation deduction, or \$5,000.

(h) Inasmuch as the sum of the amount of income required to be distributed currently to W (\$55,900) and the other amounts properly paid, credited, or required to be distributed to D (\$27,950) exceeds the distributable net income (\$82,750) of the trust as determined under section 643(a), D is deemed to have received \$26,850 (\$82,750 less \$55,900) for income tax purposes. The character of the amounts deemed distributed to her is determined as follows:

Rents ($20,550/82,750 \times \$26,850$)	\$6,668
Dividends ($39,250/82,750 \times \$26,850$)	12,735
Partially tax-exempt interest ($7,850/82,750 \times \$26,850$)	2,547
Tax-exempt interest ($15,100/82,750 \times \$26,850$)	4,900
Total	26,850

Accordingly, D will exclude \$4,900 of tax-exempt interest from gross income and will receive the credits and exclusion for dividends received and for partially tax-exempt interest provided in sections 34, 116, and 35, respectively, with respect to the dividends and partially tax-exempt interest deemed to have been distributed to her, her share of the dividends being aggregated with other dividends received by her for purposes of the dividend credit and exclusion. In addition, she may deduct a share of the depreciation deduction proportionate to the trust income allocable to her; that is, one-fourth of the total depreciation deduction, or \$2,500.

(i) [Reserved]

(j) The remaining \$2,500 of the depreciation deduction is allocated to the amount distributed to charity X and is hence non-deductible by the trust, W, or D. (See § 1.642(e)-1.)

§ 1.663(a)-1 Special rules applicable to sections 661 and 662; exclusions; gifts, bequests, etc.

(a) *In general.* A gift or bequest of a specific sum of money or of specific property, which is required by the specific terms of the will or trust instrument and is properly paid or credited to a beneficiary, is not allowed as a deduction to an estate or trust under section 661 and is not included in the gross income of a beneficiary under section 662, unless under the terms of the will or trust instrument the gift or bequest is to be paid or credited to the recipient in more than three installments. Thus, in order for a gift or bequest to be excludable from the gross income of the recipient, (1) it must qualify as a gift or bequest of a specific sum of money or of specific property (see paragraph (b) of this section), and (2) the terms of the governing instrument must not provide for its payment in more than three installments (see paragraph (c) of this section). The date when the estate came into existence or the date when the trust was created is immaterial.

(b) *Definition of a gift or bequest of a specific sum of money or of specific property.* (1) In order to qualify as a gift or bequest of a specific sum of money or of specific property under section 663(a), the amount of money or the identity of the specific property must be ascertainable under the terms of a testator's will as of the date of his death, or under the terms of an inter vivos trust instrument as of the date of the inception of the trust. For example, bequests to a decedent's son of the decedent's interest in a partnership and to his daughter of a sum of money equal to the value of the partnership interest are bequests of specific property and of a specific sum of money, respectively. On the other hand, a bequest to the decedent's spouse of money or property, to be selected by the decedent's executor, equal in value to a fraction of the decedent's "adjusted gross estate" is neither a bequest of a specific sum of money or of specific property. The identity of the

property and the amount of money specified in the preceding sentence are dependent both on the exercise of the executor's discretion and on the payment of administration expenses and other charges, neither of which are facts existing on the date of the decedent's death. It is immaterial that the value of the bequest is determinable after the decedent's death before the bequest is satisfied (so that gain or loss may be realized by the estate in the transfer of property in satisfaction of it).

(2) The following amounts are not considered as gifts or bequests of a sum of money or of specific property within the meaning of this paragraph:

(i) An amount which can be paid or credited only from the income of an estate or trust, whether from the income for the year of payment or crediting, or from the income accumulated from a prior year;

(ii) An annuity, or periodic gifts of specific property in lieu of or having the effect of an annuity;

(iii) A residuary estate or the corpus of a trust; or

(iv) A gift or bequest paid in a lump sum or in not more than three installments, if the gift or bequest is required to be paid in more than three installments under the terms of the governing instrument.

(3) The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples, in which it is assumed that the gift or bequest is not required to be made in more than three installments (see paragraph (c)):

Example 1. Under the terms of a will, a legacy of \$5,000 was left to A, 1,000 shares of X company stock was left to W, and the balance of the estate was to be divided equally between W and B. No provision was made in the will for the disposition of income of the estate during the period of administration. The estate had income of \$25,000 during the taxable year 1954, which was accumulated and added to corpus for estate accounting purposes. During the taxable year, the executor paid the legacy of \$5,000 in a lump sum to A, transferred the X company stock to W, and made no other distributions to beneficiaries. The distributions to A and W qualify for the exclusion under section 663(a)(1).

Example 2. Under the terms of a will, the testator's estate was to be distributed to A. No provision was made in the will for the