

rule may also be applicable to successive interests in point of time, as for instance in the case of a trust providing for a life estate to A and a second life estate or outright remainder to B. In such a case, in the taxable year of a trust in which a beneficiary dies items of income and deduction properly allocable under trust accounting principles to the period before a beneficiary's death are attributed to one share, and those allocable to the period after the beneficiary's death are attributed to the other share. Separate share treatment is not available to a succeeding interest, however, with respect to distributions which would otherwise be deemed distributed in a taxable year of the earlier interest under the throw-back provisions of subpart D (section 665 and following), part I, subchapter J, chapter 1 of the Code. The application of this paragraph may be illustrated by the following example:

Example. A trust instrument directs that the income of a trust is to be paid to A for her life. After her death income may be distributed to B or accumulated. A dies on June 1, 1956. The trust keeps its books on the basis of the calendar year. The trust instrument permits invasions of corpus for the benefit of A and B, and an invasion of corpus was in fact made for A's benefit in 1956. In determining the distributable net income of the trust for the purpose of determining the amounts includible in A's income, income and deductions properly allocable to the period before A's death are treated as income and deductions of a separate share; and for that purpose no account is taken of income and deductions allocable to the period after A's death.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7633, 44 FR 57926, Oct. 9, 1979; T.D. 8849, 64 FR 72543, Dec. 28, 1999]

§ 1.663(c)-4 Applicability of separate share rule to estates and qualified revocable trusts.

(a) *General rule.* The applicability of the separate share rule provided by section 663(c) to estates and qualified revocable trusts within the meaning of section 645(b)(1) will generally depend upon whether the governing instrument and applicable local law create separate economic interests in one beneficiary or class of beneficiaries of such estate or trust. Ordinarily, a separate share exists if the economic interests

of the beneficiary or class of beneficiaries neither affect nor are affected by the economic interests accruing to another beneficiary or class of beneficiaries. Separate shares include, for example, the income on bequeathed property if the recipient of the specific bequest is entitled to such income and a surviving spouse's elective share that under local law is entitled to income and appreciation or depreciation. Furthermore, a qualified revocable trust for which an election is made under section 645 is always a separate share of the estate and may itself contain two or more separate shares. Conversely, a gift or bequest of a specific sum of money or of property as defined in section 663(a)(1) is not a separate share.

(b) *Special rule for certain types of beneficial interests.* Notwithstanding the provisions of paragraph (a) of this section, a surviving spouse's elective share that under local law is determined as of the date of the decedent's death and is not entitled to income or any appreciation or depreciation is a separate share. Similarly, notwithstanding the provisions of paragraph (a) of this section, a pecuniary formula bequest that, under the terms of the governing instrument or applicable local law, is not entitled to income or to share in appreciation or depreciation constitutes a separate share if the governing instrument does not provide that it is to be paid or credited in more than three installments.

(c) *Shares with multiple beneficiaries and beneficiaries of multiple shares.* A share may be considered as separate even though more than one beneficiary has an interest in it. For example, two beneficiaries may have equal, disproportionate, or indeterminate interests in one share which is economically separate and independent from another share in which one or more beneficiaries have an interest. Moreover, the same person may be a beneficiary of more than one separate share.

[T.D. 8849, 64 FR 72544, Dec. 28, 1999]

§ 1.663(c)-5 Examples.

Section 663(c) may be illustrated by the following examples:

Example 1. (i) A single trust was created in 1940 for the benefit of A, B, and C, who were aged 6, 4, and 2, respectively. Under the terms of the instrument, the trust income is required to be divided into three equal shares. Each beneficiary's share of the income is to be accumulated until he becomes 21 years of age. When a beneficiary reaches the age of 21, his share of the income may thereafter be either accumulated or distributed to him in the discretion of the trustee. The trustee also has discretion to invade corpus for the benefit of any beneficiary to the extent of his share of the trust estate, and the trust instrument requires that the beneficiary's right to future income and corpus will be proportionately reduced. When each beneficiary reaches 35 years of age, his share of the trust estate shall be paid over to him. The interest in the trust estate of any beneficiary dying without issue and before he has attained the age of 35 is to be equally divided between the other beneficiaries of the trust. All expenses of the trust are allocable to income under the terms of the trust instrument.

(ii) No distributions of income or corpus were made by the trustee prior to 1955, although A became 21 years of age on June 30, 1954. During the taxable year of 1955, the trust has income from royalties of \$20,000 and expenses of \$5,000. The trustee in his discretion distributes \$12,000 to A. Both A and the trust report on the calendar year basis.

(iii) The trust qualifies for the separate share treatment under section 663(c) and the distributable net income must be divided into three parts for the purpose of determining the amount deductible by the trust under section 661 and the amount includible in A's gross income under section 662.

(iv) The distributable net income of each share of the trust is \$5,000 (\$6,667 less \$1,667). Since the amount (\$12,000) distributed to A during 1955 exceeds the distributable net income of \$5,000 allocated to his share, the trust is deemed to have distributed to him \$5,000 of 1955 income and \$7,000 of amounts other than 1955 income. Accordingly, the trust is allowed a deduction of \$5,000 under section 661. The taxable income of the trust for 1955 is \$9,900, computed as follows:

Royalties	\$20,000	
Deductions:		
Expenses	\$5,000	
Distribution to A	5,000	
Personal exemption	100	
		10,100
		<hr/>
Taxable income		9,900

(v) In accordance with section 662, A must include in his gross income for 1955 an amount equal to the portion (\$5,000) of the distributable net income of the trust allocated to his share. Also, the excess distribution of \$7,000 made by the trust is subject to

the throwback provisions of subpart D (section 665 and following), part I, subchapter J, chapter 1 of the Code, and the regulations thereunder.

Example 2. (i) *Facts.* Testator, who dies in 2000, is survived by a spouse and two children. Testator's will contains a fractional formula bequest dividing the residuary estate between the surviving spouse and a trust for the benefit of the children. Under the fractional formula, the marital bequest constitutes 60% of the estate and the children's trust constitutes 40% of the estate. During the year, the executor makes a partial proportionate distribution of \$1,000,000, (\$600,000 to the surviving spouse and \$400,000 to the children's trust) and makes no other distributions. The estate receives dividend income of \$20,000, and pays expenses of \$8,000 that are deductible on the estate's federal income tax return.

(ii) *Conclusion.* The fractional formula bequests to the surviving spouse and to the children's trust are separate shares. Because Testator's will provides for fractional formula residuary bequests, the income and any appreciation in the value of the estate assets are proportionately allocated between the marital share and the trust's share. Therefore, in determining the distributable net income of each share, the income and expenses must be allocated 60% to the marital share and 40% to the trust's share. The distributable net income is \$7,200 (60% of income less 60% of expenses) for the marital share and \$4,800 (40% of income less 40% of expenses) for the trust's share. Because the amount distributed in partial satisfaction of each bequest exceeds the distributable net income of each share, the estate's distribution deduction under section 661 is limited to the sum of the distributable net income for both shares. The estate is allowed a distribution deduction of \$12,000 (\$7,200 for the marital share and \$4,800 for the trust's share). As a result, the estate has zero taxable income (\$20,000 income less \$8,000 expenses and \$12,000 distribution deduction). Under section 662, the surviving spouse and the trust must include in gross income \$7,200 and \$4,800, respectively.

Example 3. The facts are the same as in *Example 2*, except that in 2000 the executor makes the payment to partially fund the children's trust but makes no payment to the surviving spouse. The fiduciary must use a reasonable and equitable method to allocate income and expenses to the trust's share. Therefore, depending on when the distribution is made to the trust, it may no longer be reasonable or equitable to determine the distributable net income for the trust's share by allocating to it 40% of the estate's income and expenses for the year. The computation of the distributable net income for the trust's share should take into

consideration that after the partial distribution the relative size of the trust's separate share is reduced and the relative size of the spouse's separate share is increased.

Example 4. (i) *Facts.* Testator, who dies in 2000, is survived by a spouse and one child. Testator's will provides for a pecuniary formula bequest to be paid in not more than three installments to a trust for the benefit of the child of the largest amount that can pass free of Federal estate tax and a bequest of the residuary to the surviving spouse. The will provides that the bequest to the child's trust is not entitled to any of the estate's income and does not participate in appreciation or depreciation in estate assets. During the 2000 taxable year, the estate receives dividend income of \$200,000 and pays expenses of \$15,000 that are deductible on the estate's federal income tax return. The executor partially funds the child's trust by distributing to it securities that have an adjusted basis to the estate of \$350,000 and a fair market value of \$380,000 on the date of distribution. As a result of this distribution, the estate realizes long-term capital gain of \$30,000.

(ii) *Conclusion.* The estate has two separate shares consisting of a formula pecuniary bequest to the child's trust and a residuary bequest to the surviving spouse. Because, under the terms of the will, no estate income is allocated to the bequest to the child's trust, the distributable net income for that trust's share is zero. Therefore, with respect to the \$380,000 distribution to the child's trust, the estate is allowed no deduction under section 661, and no amount is included in the trust's gross income under section 662. Because no distributions were made to the spouse, there is no need to compute the distributable net income allocable to the marital share. The taxable income of the estate for the 2000 taxable year is \$214,400 (\$200,000 (dividend income) plus \$30,000 (capital gain) minus \$15,000 (expenses) and minus \$600 (personal exemption)).

Example 5. The facts are the same as in *Example 4*, except that during 2000 the estate reports on its federal income tax return a pro rata share of an S corporation's tax items and a distributive share of a partnership's tax items allocated on Form K-1s to the estate by the S corporation and by the partnership, respectively. Because, under the terms of the will, no estate income from the S corporation or the partnership would be allocated to the pecuniary bequest to child's trust, none of the tax items attributable to the S corporation stock or the partnership interest is allocated to the trust's separate share. Therefore, with respect to the \$380,000 distribution to the trust, the estate is allowed no deduction under section 661, and no amount is included in the trust's gross income under section 662.

Example 6. The facts are the same as in *Example 4*, except that during 2000 the estate re-

ceives a distribution of \$900,000 from the decedent's individual retirement account that is included in the estate's gross income as income in respect of a decedent under section 691(a). The entire \$900,000 is allocated to corpus under applicable local law. Both the separate share for the child's trust and the separate share for the surviving spouse may potentially be funded with the proceeds from the individual retirement account. Therefore, a portion of the \$900,000 gross income must be allocated to the trust's separate share. The amount allocated to the trust's share must be based upon the relative values of the two separate shares using a reasonable and equitable method. The estate is entitled to a deduction under section 661 for the portion of the \$900,000 properly allocated to the trust's separate share, and the trust must include this amount in income under section 662.

Example 7. (i) *Facts.* Testator, who dies in 2000, is survived by a spouse and three adult children. Testator's will divides the residue of the estate equally among the three children. The surviving spouse files an election under the applicable state's elective share statute. Under this statute, a surviving spouse is entitled to one-third of the decedent's estate after the payment of debts and expenses. The statute also provides that the surviving spouse is not entitled to any of the estate's income and does not participate in appreciation or depreciation of the estate's assets. However, under the statute, the surviving spouse is entitled to interest on the elective share from the date of the court order directing the payment until the executor actually makes payment. During the estate's 2001 taxable year, the estate distributes to the surviving spouse \$5,000,000 in partial satisfaction of the elective share and pays \$200,000 of interest on the delayed payment of the elective share. During that year, the estate receives dividend income of \$3,000,000 and pays expenses of \$60,000 that are deductible on the estate's federal income tax return.

(ii) *Conclusion.* The estate has four separate shares consisting of the surviving spouse's elective share and each of the three children's residuary bequests. Because the surviving spouse is not entitled to any estate income under state law, none of the estate's gross income is allocated to the spouse's separate share for purposes of determining that share's distributable net income. Therefore, with respect to the \$5,000,000 distribution, the estate is allowed no deduction under section 661, and no amount is included in the spouse's gross income under section 662. The \$200,000 of interest paid to the spouse must be included in the spouse's gross income under section 61. Because no distributions were made to any other beneficiaries during the year, there is no need to compute the distributable net income of the other three

separate shares. Thus, the taxable income of the estate for the 2000 taxable year is \$2,939,400 (\$3,000,000 (dividend income) minus \$60,000 (expenses) and \$600 (personal exemption)). The estate's \$200,000 interest payment is a nondeductible personal interest expense described in section 163(h).

Example 8. The will of Testator, who dies in 2000, directs the executor to distribute the X stock and all dividends therefrom to child A and the residue of the estate to child B. The estate has two separate shares consisting of the income on the X stock bequeathed to A and the residue of the estate bequeathed to B. The bequest of the X stock meets the definition of section 663(a)(1) and therefore is not a separate share. If any distributions, other than shares of the X stock, are made during the year to either A or B, then for purposes of determining the distributable net income for the separate shares, gross income attributable to dividends on the X stock must be allocated to A's separate share and any other income must be allocated to B's separate share.

Example 9. The will of Testator, who dies in 2000, directs the executor to divide the residue of the estate equally between Testator's two children, A and B. The will directs the executor to fund A's share first with the proceeds of Testator's individual retirement account. The date of death value of the estate after the payment of debts, expenses, and estate taxes is \$9,000,000. During 2000, the \$900,000 balance in Testator's individual retirement account is distributed to the estate. The entire \$900,000 is allocated to corpus under applicable local law. This amount is income in respect of a decedent within the meaning of section 691(a). The estate has two separate shares, one for the benefit of A and one for the benefit of B. If any distributions are made to either A or B during the year, then, for purposes of determining the distributable net income for each separate share, the \$900,000 of income in respect of a decedent must be allocated to A's share.

Example 10. The facts are the same as in *Example 9*, except that the will directs the executor to fund A's share first with X stock valued at \$3,000,000, rather than with the proceeds of the individual retirement account. The estate has two separate shares, one for the benefit of A and one for the benefit of B. If any distributions are made to either A or B during the year, then, for purposes of determining the distributable net income for each separate share, the \$900,000 of gross income attributable to the proceeds from the individual retirement account must be allocated between the two shares to the extent that they could potentially be funded with those proceeds. The maximum amount of A's share that could potentially be funded with the income in respect of decedent is \$1,500,000 (\$4,500,000 value of share less \$3,000,000 to be funded with stock) and the maximum

amount of B's share that could potentially be funded with income in respect of decedent is \$4,500,000. Based upon the relative values of these amounts, the gross income attributable to the proceeds of the individual retirement account is allocated \$225,000 (or one-fourth) to A's share and \$675,000 (or three-fourths) to B's share.

Example 11. The will of Testator, who dies in 2000, provides that after the payment of specific bequests of money, the residue of the estate is to be divided equally among the Testator's three children, A, B, and C. The will also provides that during the period of administration one-half of the income from the residue is to be paid to a designated charitable organization. After the specific bequests of money are paid, the estate initially has three equal separate shares. One share is for the benefit of the charitable organization and A, another share is for the benefit of the charitable organization and B, and the last share is for the benefit of the charitable organization and C. During the period of administration, payments of income to the charitable organization are deductible by the estate to the extent provided in section 642(c) and are not subject to the distribution provisions of sections 661 and 662.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960. Redesignated and amended by T.D. 8849, 64 FR 72543, 72544, Dec. 28, 1999; 65 FR 16317, Mar. 28, 2000]

§ 1.663(c)-6 Effective dates.

Sections 1.663(c)-1 through 1.663(c)-5 are applicable for estates and qualified revocable trusts within the meaning of section 645(b)(1) with respect to decedents who die on or after December 28, 1999. However, for estates and qualified revocable trusts with respect to decedents who died after the date that section 1307 of the Tax Reform Act of 1997 became effective but before December 28, 1999, the IRS will accept any reasonable interpretation of the separate share provisions, including those provisions provided in 1999-11 I.R.B. 41 (see § 601.601(d)(2)(ii)(b) of this chapter). For trusts other than qualified revocable trusts, § 1.663(c)-2 is applicable for taxable years of such trusts beginning after December 28, 1999.

[T.D. 8849, 64 FR 72545, Dec. 28, 1999; 65 FR 16317, Mar. 28, 2000]

§ 1.664-1 Charitable remainder trusts.

(a) *In general*—(1) *Introduction*—(i) *General description of a charitable remainder trust.* Generally, a charitable