

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

remainder trust is a trust which provides for a specified distribution, at least annually, to one or more beneficiaries, at least one of which is not a charity, for life or for a term of years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, charity. The specified distribution to be paid at least annually must be a sum certain which is not less than 5 percent of the initial net fair market value of all property placed in trust (in the case of a charitable remainder annuity trust) or a fixed percentage which is not less than 5 percent of the net fair market value of the trust assets, valued annually (in the case of a charitable remainder unitrust). A trust created after July 31, 1969, which is a charitable remainder trust is exempt from all of the taxes imposed by subtitle A of the Code for any taxable year of the trust except a taxable year in which it has unrelated business taxable income.

(ii) *Scope.* This section provides definitions, general rules governing the creation and administration of a charitable remainder trust, and rules governing the taxation of the trust and its beneficiaries. For the application of certain foundation rules to charitable remainder trusts, see paragraph (b) of this section. If the trust has unrelated business taxable income, see paragraph (c) of this section. For the treatment of distributions to recipients, see paragraph (d) of this section. For the treatment of distributions to charity, see paragraph (e) of this section. For the time limitations for amendment of governing instruments, see paragraph (f) of this section. For transitional rules under which particular requirements are inapplicable to certain trusts, see paragraph (g) of this section. Section 1.664-2 provides rules relating solely to a charitable remainder annuity trust. Section 1.664-3 provides rules relating solely to a charitable remainder unitrust. Section 1.664-4 provides rules governing the calculation of the fair market value of the remainder interest in a charitable remainder unitrust. For rules relating to the filing of returns for a charitable remainder trust, see paragraph (a)(6) of § 1.6012-3 and section 6034 and the regulations thereunder.

(iii) *Definitions.* As used in this section and §§ 1.664-2, 1.664-3, and 1.664-4:

(a) *Charitable remainder trust.* The term *charitable remainder trust* means a trust with respect to which a deduction is allowable under section 170, 2055, 2106, or 2522 and which meets the description of a charitable remainder annuity trust (as described in § 1.664-2) or a charitable remainder unitrust (as described in § 1.664-3).

(b) *Annuity amount.* The term *annuity amount* means the amount described in paragraph (a)(1) of § 1.664-2 which is payable, at least annually, to the beneficiary of a charitable remainder annuity trust.

(c) *Unitrust amount.* The term *unitrust amount* means the amount described in paragraph (a)(1) of § 1.664-3 which is payable, at least annually, to the beneficiary of a charitable remainder unitrust.

(d) *Recipient.* The term *recipient* means the beneficiary who receives the possession or beneficial enjoyment of the annuity amount or unitrust amount.

(e) *Governing instrument.* The term *governing instrument* has the same meaning as in section 508(e) and the regulations thereunder.

(2) *Requirement that the trust must be either a charitable remainder annuity trust or a charitable remainder unitrust.* A trust is a charitable remainder trust only if it is either a charitable remainder annuity trust in every respect or a charitable remainder unitrust in every respect. For example, a trust which provides for the payment each year to a noncharitable beneficiary of the greater of a sum certain or a fixed percentage of the annual value of the trust assets is not a charitable remainder trust inasmuch as the trust is neither a charitable remainder annuity trust (for the reason that the payment for the year may be a fixed percentage of the annual value of the trust assets which is not a "sum certain") nor a charitable remainder unitrust (for the reason that the payment for the year may be a sum certain which is not a "fixed percentage" of the annual value of the trust assets).

(3) *Restrictions on investments.* A trust is not a charitable remainder trust if the provisions of the trust include a

provision which restricts the trustee from investing the trust assets in a manner which could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets. In the case of transactions with, or for the benefit of, a disqualified person, see section 4941(d) and the regulations thereunder for rules relating to the definition of self-dealing.

(4) *Requirement that trust must meet definition of and function exclusively as a charitable remainder trust from its creation.* In order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for the purposes of section 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code (relating to grantors and others treated as substantial owners), but in no event prior to the time property is first transferred to the trust. For purposes of the preceding sentence, neither the grantor nor his spouse shall be treated as the owner of the trust under such subpart E merely because the grantor or his spouse is named as a recipient. See examples 1 through 3 of subparagraph (6) of this paragraph for illustrations of the foregoing rule.

(5) *Rules applicable to testamentary transfers—(i) Deferral of annuity or unitrust amount.* Notwithstanding subparagraph (4) of this paragraph and §§ 1.664-2 and 1.664-3, for purposes of sections 2055 and 2106 a charitable remainder trust shall be deemed created at the date of death of the decedent (even though the trust is not funded until the end of a reasonable period of administration or settlement) if the obligation to pay the annuity or unitrust amount with respect to the property passing in trust at the death of the decedent begins as of the date of death of the decedent, even though the requirement to pay such amount is deferred in accordance with the rules provided in this subparagraph. If permitted by applicable local law or authorized by the provisions of the gov-

erning instrument, the requirement to pay such amount may be deferred until the end of the taxable year of the trust in which occurs the complete funding of the trust. Within a reasonable period after such time, the trust must pay (in the case of an underpayment) or must receive from the recipient (in the case of an overpayment) the difference between:

(a) Any annuity or unitrust amounts actually paid, plus interest on such amounts computed at the rate of interest specified in paragraph (a)(5)(iv) of this section, compounded annually, and

(b) The annuity or unitrust amounts payable, plus interest on such amounts computed at the rate of interest specified in paragraph (a)(5)(iv) of this section, compounded annually.

The amounts payable shall be retroactively determined by using the taxable year, valuation method, and valuation dates which are ultimately adopted by the charitable remainder trust. See subdivision (ii) of this subparagraph for rules relating to retroactive determination of the amount payable under a charitable remainder unitrust. See paragraph (d)(4) of this section for rules relating to the year of inclusion in the case of an underpayment to a recipient and the allowance of a deduction in the case of an overpayment to a recipient.

(ii) For purposes of retroactively determining the amount under subdivision (i)(b) of this subparagraph, the governing instrument of a charitable remainder unitrust may provide that the amount described in subdivision (i)(b) of this subparagraph with respect to property passing in trust at the death of the decedent for the period which begins on the date of death of the decedent and ends on the earlier of the date of death of the last recipient or the end of the taxable year of the trust in which occurs the complete funding of the trust shall be computed by multiplying:

(a) The sum of (1) the value, on the earlier of the date of death of the last recipient or the last day in such taxable year, of the property held in trust which is attributable to property passing to the trust at the death of the decedent, (2) any distributions in respect of unitrust amounts made by the trust

or estate before such date, and (3) interest on such distributions computed at the rate of interest specified in paragraph (a)(5)(iv) of this section, compounded annually, from the date of distribution to such date by:

(b) (1) In the case of transfers made after November 30, 1983, for which the valuation date is before May 1, 1989, a factor equal to 1.000000 less the factor under the appropriate adjusted payout rate in Table D in § 1.664-4(e)(6) opposite the number of years in column 1 between the date of death of the decedent and the date of the earlier of the death of the last recipient or the last day of such taxable year.

(2) In the case of transfers for which the valuation date is after April 30, 1989, a factor equal to 1.000000 less the factor under the appropriate adjusted payout rate in Table D in § 1.664-4(e)(6) opposite the number of years in column 1 between the date of death of the decedent and the date of the earlier of the death of the last recipient or the last day of such taxable year. The appropriate adjusted payout rate is determined by using the appropriate Table F contained in § 1.664-4(e)(6) for the section 7520 rate for the month of the valuation date.

(3) If the number of years between the date of death and the date of the earlier of the death of the last recipient or the last day of such taxable year is between periods for which factors are provided, a linear interpolation must be made.

(iii) *Treatment of distributions.* The treatment of a distribution to a charitable remainder trust, or to a recipient in respect of an annuity or unitrust amount, paid, credited, or required to be distributed by an estate, or by a trust which is not a charitable remainder trust, shall be governed by the rules of subchapter J, chapter 1, subtitle A of the Code other than section 664. In the case of a charitable remainder trust which is partially or fully funded during the period of administration of an estate or settlement of a trust (which is not a charitable remainder trust), the treatment of any amount paid, credited, or required to be distributed by the charitable remainder trust shall be governed by the rules of section 664.

(iv) *Rate of interest.* The following rates of interest shall apply for purposes of paragraphs (a)(5) (i) through (ii) of this section:

(a) The section 7520 rate for the month in which the valuation date with respect to the transfer is (or one of the prior two months if elected under § 1.7520-2(b)) after April 30, 1989;

(b) 10 percent for instruments executed or amended (other than in the case of a reformation under section 2055(e)(3)) on or after August 9, 1984, and before May 1, 1989, and not subsequently amended;

(c) 6 percent or 10 percent for instruments executed or amended (other than in the case of a reformation under section 2055(e)(3)) after October 24, 1983, and before August 9, 1984; and

(d) 6 percent for instruments executed before October 25, 1983, and not subsequently amended (other than in the case of a reformation under section 2055(e)(3)).

(6) *Examples.* The application of the rules in paragraphs (a)(4) and (a)(5) of this section require the use of actuarial factors contained in §§ 1.664-4(e) and 1.664-4A(d) and (e) and may be illustrated by use of the following examples:

*Example (1).* On September 19, 1971, H transfers property to a trust over which he retains an inter vivos power of revocation. The trust is to pay W 5 percent of the value of the trust assets, valued annually, for her life, remainder to charity. The trust would satisfy all of the requirements of section 664 if it were irrevocable. For purposes of section 664, the trust is not deemed created in 1971 because H is treated as the owner of the entire trust under subpart E. On May 26, 1975, H predeceases W at which time the trust becomes irrevocable. For purposes of section 664, the trust is deemed created on May 26, 1975, because that is the earliest date on which H is not treated as the owner of the entire trust under subpart E. The trust becomes a charitable remainder trust on May 26, 1975, because it meets the definition of a charitable remainder trust from its creation.

*Example (2).* The facts are the same as in example (1), except that H retains the inter vivos power to revoke only one-half of the trust. For purposes of section 664, the trust is deemed created on September 19, 1971, because on that date the grantor is not treated as the owner of the entire trust under subpart E. Consequently, a charitable deduction is not allowable either at the creation of the trust or at H's death because the trust does

not meet the definition of a charitable remainder trust from the date of its creation. The trust does not meet the definition of a charitable remainder trust from the date of its creation because the trust is subject to a partial power to revoke on such date.

*Example (3).* The facts are the same as in example (1), except that the residue of H's estate is to be paid to the trust and the trust is required to pay H's debts. The trust is not a charitable remainder trust at H's death because it does not function exclusively as a charitable remainder trust from the date of its creation which, in this case, is the date it becomes irrevocable.

*Example (4).* (i) In 1971, H transfers property to Trust A over which he retains an inter vivos power of revocation. Trust A, which is not a charitable remainder trust, is to provide income or corpus to W until the death of H. Upon H's death the trust is required by its governing instrument to pay the debts and administration expenses of H's estate, and then to terminate and distribute all of the remaining assets to a separate Trust B which meets the definition of a charitable remainder annuity trust.

(ii) Trust B will be charitable remainder trust from the date of its funding because it will function exclusively as a charitable remainder trust from its creation. For purposes of section 2055, Trust B will be deemed created at H's death if the obligation to pay the annuity amount begins on the date of H's death. For purposes of section 664, Trust B becomes a charitable remainder trust as soon as it is partially or completely funded. Consequently, unless Trust B has unrelated business taxable income, the income of the trust is exempt from all taxes imposed by subtitle A of the Code, and any distributions by the trust, even before it is completely funded, are governed by the rules of section 664. Any distributions made by Trust A, including distributions to a recipient in respect of annuity amounts, are governed by the rules of subchapter J, chapter 1, subtitle A of the Code other than section 664.

*Example (5).* In 1973, H dies testate leaving the net residue of his estate (after payment by the estate of all debts and administration expenses) to a trust which meets the definition of a charitable remainder unitrust. For purposes of section 2055, the trust is deemed created at H's death if the requirement to pay the unitrust amount begins on H's death and is a charitable remainder trust even though the estate is obligated to pay debts and administration expenses.

For purposes of section 664, the trust becomes a charitable remainder trust as soon as it is partially or completely funded. Consequently, unless the trust has unrelated business taxable income, the income of the trust is exempt from all taxes imposed by subtitle A of the Code, and any distributions by the trust, even before it is completely

funded, are governed by the rules of section 664. Any distributions made by H's estate, including distributions to a recipient in respect of unitrust amounts, are governed by the rules of subchapter J, chapter 1, subtitle A of the Code other than section 664.

*Example (6).* (i) On January 1, 1974, H dies testate leaving the residue of his estate to a charitable remainder unitrust. The governing instrument provides that, beginning at H's death, the trustee is to make annual payments to W, on December 31 of each year of 5 percent of the net fair market value of the trust assets, valued as of December 31 of each year, for W's life and to pay the remainder to charity at the death of W. The governing instrument also provides that the actual payment of the unitrust amount need not be made until the end of the taxable year of the trust in which occurs the complete funding of the trust. The governing instrument also provides that the amount payable with respect to the period between the date of death and the end of such taxable year shall be computed under the special method provided in subparagraph (5)(ii) of this paragraph. The governing instrument provides that, within a reasonable period after the end of the taxable year of the trust in which occurs the complete funding of the trust, the trustee shall pay (in the case of an underpayment) or shall receive from the recipient (in the case of an overpayment) the difference between the unitrust amounts paid (plus interest at 6 percentage compounded annually) and the amount computed under the special method. The trust is completely funded on September 20, 1976. No amounts were paid before June 30, 1977. The trust adopts a fiscal year of July 1 to June 30. The net fair market value of the trust assets on June 30, 1977, is \$100,000.

(ii) Because no amounts were paid prior to the end of the taxable year in which the trust was completely funded, the amount payable at the end of such taxable year is equal to the net fair market value of the trust assets on the last day of such taxable year (June 30, 1977) multiplied by a factor equal to 1.0 minus the factor in Table D corresponding to the number of years in the period between the date of death and the end of such taxable year. The adjusted payout rate (determined under § 1.664-4A(c)) is 5 percent. Because the last day of the taxable year in which the trust is completely funded in June 30, 1977, there are 3 181/365 years in such period. Because there is no factor given in Table D for such a period, a linear interpolation must be made:

1.0 minus 0.814506 (factor at 5 percent for 4 years) .....	0.185494
1.0 minus 0.857375 (factor at 5 percent for 3 years) .....	.142625
Difference .....	.042869

$181+365=X+0.042869$	
$X=0.021258$	
1.0 minus 0.857375 (factor at 5 percent for 3 years .....	0.142625
Plus: X .....	.021258
Interpolated factor .....	.163883

Thus, the amount payable for the period from January 1, 1974, to June 30, 1977, is \$16,388.30 ( $\$100,000 \times 0.163883$ ). Thereafter, the trust assets must be valued on December 31 of each year and 5 percent of such value paid annually to W for her life.

(7) *Valuation of unmarketable assets—*

(i) *In general.* If unmarketable assets are transferred to or held by a trust, the trust will not be a trust with respect to which a deduction is available under section 170, 2055, 2106, or 2522, or will be treated as failing to function exclusively as a charitable remainder trust unless, whenever the trust is required to value such assets, the valuation is—

(a) Performed exclusively by an independent trustee; or

(b) Determined by a *current qualified appraisal*, as defined in § 1.170A-13(c)(3), from a *qualified appraiser*, as defined in § 1.170A-13(c)(5).

(ii) *Unmarketable assets.* Unmarketable assets are assets that are not cash, cash equivalents, or other assets that can be readily sold or exchanged for cash or cash equivalents. For example, unmarketable assets include real property, closely-held stock, and an unregistered security for which there is no available exemption permitting public sale.

(iii) *Independent trustee.* An independent trustee is a person who is not the grantor of the trust, a noncharitable beneficiary, or a related or subordinate party to the grantor, the grantor's spouse, or a noncharitable beneficiary (within the meaning of section 672(c) and the applicable regulations).

(b) *Application of certain foundation rules to charitable remainder trusts.* See section 4947(a)(2) and section 4947(b)(3)(B) and the regulations thereunder for the application to charitable remainder trusts of certain provisions relating to private foundations. See section 508(e) for rules relating to required provisions in governing instru-

ments prohibiting certain activities specified in section 4947(a)(2).

(c) *Taxation of nonexempt charitable remainder trusts.* If the charitable remainder trust has any unrelated business taxable income (within the meaning of section 512 and the regulations thereunder, determined as if part III, subchapter F, chapter 1, subtitle A of the Code applied to such trust) for any taxable year, the trust is subject to all of the taxes imposed by subtitle A of the Code for such taxable year. For taxable years beginning after December 31, 1969, unrelated business taxable income includes debt-financed income. The taxes imposed by subtitle A of the Code upon a nonexempt charitable remainder trust shall be computed under the rules prescribed by subparts A and C, part 1, subchapter J, chapter 1, subtitle A of the Code for trusts which may accumulate income or which distribute corpus. The provisions of subpart E, part 1 of such subchapter J are not applicable with respect to a nonexempt charitable remainder trust. The application of the above rules may be illustrated by the following example:

*Example.* In 1975, a charitable remainder trust which has a calendar year as its taxable year has \$1,000 of ordinary income, including \$100 of unrelated business taxable income, and no deductions other than under sections 642(b) and 661(a). The trust is required to pay out \$700 for 1975 to a noncharitable recipient. Because the trust has some unrelated business taxable income in 1975, it is not exempt for such year. Consequently, the trust is taxable on all of its income as a complex trust. Under section 661(a) of the Code, the trust is allowed a deduction of \$700. Under section 642(b) of the Code, the trust is allowed a deduction of \$100. Consequently, the taxable income of the trust for 1975 is \$200 ( $\$1,000 - \$700 - \$100$ ).

(d) *Treatment of annual distributions to recipients—(1) Character of distributions—(i) Order of distributions.* Annuity and unitrust amounts shall be treated as having the following characteristics in the hands of the recipients (whether or not the trust is exempt) without credit for any taxes which are imposed by subtitle A of the Code on the trust:

(a) *Ordinary income.* First, as ordinary income to the extent of the sum of the trust's ordinary income for the

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taxable year of the trust and its undistributed ordinary income for prior years. An ordinary loss for the current year shall be used to reduce undistributed ordinary income for prior years and any excess shall be carried forward indefinitely to reduce ordinary income for future years. For purposes of this section, the amount of current and prior years' income shall be computed without regard to the deduction for net operating losses provided by sections 172 or 642(d).

(b) *Capital gain.* Second, as capital gain to the extent of the trust's undistributed capital gains. Undistributed capital gains of the trust are determined on a cumulative net basis under the rules of this subdivision without regard to the provisions of section 1212.

(1) *Long- and short-term capital gains.* If, in any taxable year of the trust, the trust has both undistributed short-term capital gain and undistributed long-term capital gain, then the short term capital gain shall be deemed distributed prior to any long-term capital gain.

(2) *Capital losses in excess of capital gains.* If the trust has for any taxable year capital losses in excess of capital gains, any excess of the net short-term capital loss over the net long-term capital gain for such year shall be a short-term capital loss in the succeeding taxable year and any excess of the net long-term capital loss over the net short-term capital gain for such year shall be a long-term capital loss in the succeeding taxable year.

(3) *Capital gains in excess of capital losses.* If the trust has for any taxable year capital gains in excess of capital losses, any excess of the net short-term capital gain over the net long-term capital loss for such year shall be, to the extent not deemed distributed, a short-term capital gain in the succeeding taxable year and any excess of the net long-term capital gain over the net short-term capital loss for such year shall be, to the extent not deemed distributed, a long-term capital gain in the succeeding taxable year.

The application of the rules in this subdivision (b) may be illustrated by the following example:

*Example.* (i) The X Trust is a charitable remainder trust created on January 1, 1975, and

has the calendar year as its taxable year. During the years indicated, it has the following capital transactions:

1975:		
	Long-term capital loss .....	\$10
	Short-term capital gain .....	5
1976:		
	Short-term capital gain .....	20
	Short-term capital loss .....	5
1977:		
	Long-term capital gain .....	15

Distributions for 1975 and 1976 were not in excess of current and accumulated ordinary income for those years. In 1977, distributions exceeded current and accumulated ordinary income by \$5.

(ii) The treatment of the 1975 and 1976 transactions is as follows:

1975:		
	Long-term capital loss recognized .....	\$(10)
	Short-term capital gain recognized .....	5
	Net long-term capital loss carried forward to 1976 .....	(5)
1976:		
	Short-term capital gain recognized .....	20
	Short-term capital loss recognized .....	(5)
	Long-term capital loss carried forward from 1975 .....	(5)
	Net short-term capital gain carried forward to 1977 .....	\$10
1977:		
	Long-term capital gain recognized .....	15
	Net short-term capital gain carried forward from 1976 .....	10

(iii) *Application of section 643(a)(7).* For application of the anti-abuse rule of section 643(a)(7) to distributions from charitable remainder trusts, see § 1.643(a)-8.

(iv) In 1977, the trust has long-term capital gain of \$15 and short-term capital gain of \$10. If the trust has both short-term capital gain and long-term capital gain for the same taxable year, the short-term capital gain is deemed distributed prior to the long-term capital gain. Therefore, the distribution of \$5 in 1977 is deemed to be short-term capital gain. The undistributed net short-term capital gain of \$5 is a short-term capital gain carried forward to 1978. The undistributed net long-term capital gain of \$15 is a long-term capital gain carried forward to 1978.

(c) *Other income.* Third, as other income (including income excluded under part III, subchapter B, chapter 1, subtitle A of the Code) to the extent of the sum of the trust's other income for the taxable year and its undistributed other income for prior years. A loss in this category for the current year shall be used to reduce undistributed income in such category for prior years and

any excess shall be carried forward indefinitely to reduce such income for future years.

(d) *Corpus*. Finally, as a distribution of trust corpus. For purposes of this section, the term *corpus* means the net fair market value of the trust assets less the total undistributed income (but not loss) in each of the above categories.

(ii) *Rules relating to character of distributions*. The determination of the character of amounts distributed shall be made as of the end of the taxable year of the trust. Amounts treated as paid from one of the categories of income described in (a), (b), or (c) of subdivision (i) of this subparagraph shall be treated as consisting of the same proportion of each class of items included in such category as the total of the current and accumulated income of each class of items bears to the total of the current and accumulated income for that category. A loss in one of such categories may not be used to reduce a gain in any other category. The provisions of subparts D and E, part 1, subchapter J, chapter 1, subtitle A of the Code are not applicable with respect to a charitable remainder trust (regardless of whether the trust is exempt).

(iii) *Application of section 643(a)(7)*. For application of the anti-abuse rule of section 643(a)(7) to distributions from charitable remainder trusts, see § 1.643(a)-8.

(iv) *Example*. The following example illustrates the application of this paragraph (d)(1):

*Example*. (i) *X* is a charitable remainder unitrust described in section 664(d)(2) and (3). The annual unitrust amount is the lesser of the amount of trust income, as defined in § 1.664-3(a)(1)(i)(b), or six percent of the net fair market value of the trust assets valued annually. The net fair market value of the trust assets on the valuation date in 1996 is \$150,000. During 1996, *X* has \$7,500 of income after allocating all expenses. All of *X*'s income for 1996 is tax-exempt income. At the end of 1996, *X*'s ordinary income for the current taxable year and undistributed ordinary income for prior years are both zero; *X*'s capital gain for the current taxable year is zero and undistributed capital gain for prior years is \$30,000; and *X*'s tax-exempt income for the current year is \$7,500 and undistributed tax-exempt income for prior years is \$2,500.

(ii) Because the trust income of \$7,500 is less than the fixed percentage amount of \$9,000, the unitrust amount for 1996 is \$7,500. The character of that amount in the hands of the recipient of the unitrust amount is determined under section 664(b). Because the unitrust amount is less than *X*'s undistributed capital gain income, the recipient of the unitrust amount treats the distribution of \$7,500 as capital gain. At the beginning of 1997, *X*'s undistributed capital gain for prior years is reduced to \$22,500, and *X*'s undistributed tax-exempt income is increased to \$10,000.

(2) *Allocation of deductions*. Items of deduction of the trust for a taxable year of the trust which are deductible in determining taxable income (other than the deductions permitted by sections 642(b), 642(c), 661, and 1202) which are directly attributable to one or more classes of items within a category of income or to corpus (determined under subparagraph (1)(i) of this paragraph) shall be allocated to such classes of items or to corpus. All other allowable deductions for such taxable year which are not directly attributable to one or more classes of items within a category of income or to corpus (other than the deductions permitted by sections 642(b), 642(c), 661, and 1202) shall be allocated among the classes of items within the category (excluding classes of items with net losses) on the basis of the gross income of such classes for such taxable year reduced by the deductions allocated thereto under the first sentence of this subparagraph, but in no event shall the amount of expenses allocated to any class of items exceed such income of such class for the taxable year. Items of deduction which are not allocable under the above two sentences (other than the deductions permitted by sections 642(b), 642(c), 661, and 1202) may be allocated in any manner. All taxes imposed by subtitle A of the Code for which the trust is liable because it has unrelated business taxable income and all taxes imposed by chapter 42 of the Code shall be allocated to corpus. Any expense which is not deductible in determining taxable income and which is not allocable to any class of items described in subparagraph (1)(i)(c) of this paragraph shall be allocated to corpus. The deductions allowable to a trust under sections 642(b), 642(c), 661, and



1202 are not allowed in determining the amount or character of any class of items within a category of income or corpus in the categories described in subparagraph (1) of this paragraph.

(3) *Allocation of income among recipients.* If there are two or more recipients, each will be treated as receiving his pro rata portion of the categories of income and corpus. The application of this rule may be illustrated by the following example:

*Example.* X transfers \$40,000 to a charitable remainder annuity trust which is to pay \$3,000 per year to X and \$2,000 per year to Y for a term of 5 years. During the first taxable year the trust has \$3,000 of ordinary income, \$500 of capital gain, and \$500 of tax-exempt income after allocation of all expenses. X is treated as receiving ordinary income of \$1,800 ( $\$3,000/\$5,000 \times \$3,000$ ), capital gain of \$300 ( $\$3,000/\$5,000 \times \$500$ ), tax exempt income of \$300 ( $\$3,000/\$5,000 \times \$500$ ), and corpus of \$600 ( $\$3,000/\$5,000 \times [\$5,000 - \$4,000]$ ). Y is treated as receiving ordinary income of \$1,200 ( $\$2,000/\$5,000 \times \$3,000$ ), capital gain of \$200 ( $\$2,000/\$5,000 \times \$500$ ), tax exempt income of \$200 ( $\$2,000/\$5,000 \times \$500$ ), and corpus of \$400 ( $\$2,000/\$5,000 \times [\$5,000 - \$4,000]$ ).

(4) *Year of inclusion—(i) General rule.* To the extent required by this paragraph, the annuity or unitrust amount is includible in the recipient's gross income for the taxable year in which the annuity or unitrust amount is required to be distributed even though the annuity or unitrust amount is not distributed until after the close of the taxable year of the trust. If a recipient has a different taxable year (as defined in section 441 or 442) from the taxable year of the trust, the amount he is required to include in gross income to the extent required by this paragraph shall be included in his taxable year in which or with which ends the taxable year of the trust in which such amount is required to be distributed.

(ii) *Payments resulting from incorrect valuations.* Notwithstanding subdivision (i) of this subparagraph, any payments which are made or required to be distributed by a charitable remainder trust pursuant to paragraph (a)(5) of this section, under paragraph (f)(3) of this section because of an amendment to the governing instrument, or under paragraphs (a)(1) of §§ 1.664-2 and 1.664-3 because of an incorrect valuation, shall, to the extent required by this

paragraph, be included in the gross income of the recipient in his taxable year in which or with which ends the taxable year of the trust in which the amount is paid, credited, or required to be distributed. For rules relating to required adjustments of underpayments and overpayments of the annuity or unitrust amounts in respect of payments made prior to the amendment of a governing instrument, see paragraph (f)(3) of this section. There is allowable to a recipient a deduction from gross income for any amounts repaid to the trust because of an overpayment during the reasonable period of administration or settlement or until the trust is fully funded, because of an amendment, or because of an incorrect valuation, to the extent such amounts were included in his gross income. See section 1341 and the regulations thereunder for rules relating to the computation of tax where a taxpayer restores substantial amounts held under a claim of right.

(iii) *Rules applicable to year of recipient's death.* If the taxable year of the trust does not end with or within the last taxable year of the recipient because of the recipient's death, the extent to which the annuity or unitrust amount required to be distributed to him is included in the gross income of the recipient for his last taxable year, or in the gross income of his estate, is determined by making the computations required under this paragraph for the taxable year of the trust in which his last taxable year ends. (The last sentence of subdivision (i) of this subparagraph does not apply to such amounts.) The gross income for the last taxable year of a recipient on the cash basis includes (to the extent required by this paragraph) amounts actually distributed to the recipient before his death. Amounts required to be distributed which are distributed to his estate, are included (to the extent required by this paragraph) in the gross income of the estate as income in respect of a decedent under section 691.

(5) *Distributions in kind.* The annuity or unitrust amount may be paid in cash or in other property. In the case

of a distribution made in other property, the amount paid, credited, or required to be distributed shall be considered as an amount realized by the trust from the sale or other disposition of property. The basis of the property in the hands of the recipient is its fair market value at the time it was paid, credited, or required to be distributed. The application of these rules may be illustrated by the following example:

*Example.* On January 1, 1971, X creates a charitable remainder annuity trust, whose taxable year is the calendar year, under which X is to receive \$5,000 per year. During 1971, the trust receives \$500 of ordinary income. On December 31, 1971, the trust distributed cash of \$500 and a capital asset of the trust having a fair market value of \$4,500 and a basis of \$2,200. The trust is deemed to have realized a capital gain of \$2,300. X treats the distribution of \$5,000 as being ordinary income of \$500, capital gain of \$2,300 and trust corpus of \$2,200. The basis of the distributed property is \$4,500 in the hands of X.

(e) *Other distributions*—(1) *Character of distributions.* An amount distributed by the trust to an organization described in section 170(c) other than the annuity or unitrust amount shall be considered as a distribution of corpus and of those categories of income specified in paragraph (d)(1) of this section in an order inverse to that prescribed in such paragraph. The character of such amount shall be determined as of the end of the taxable year of the trust in which the distribution is made after the character of the annuity or unitrust amount has been determined.

(2) *Distributions in kind.* In the case of a distribution of an amount to which subparagraph (1) of this paragraph applies, no gain or loss is realized by the trust by reason of a distribution in kind unless such distribution is in satisfaction of a right to receive a distribution of a specific dollar amount or in specific property other than that distributed.

(f) *Effective date*—(1) *General rule.* The provisions of this section are effective with respect to transfers in trust made after July 31, 1969. Any trust created (within the meaning of applicable local law) prior to August 1, 1969, is not a charitable remainder trust even if it otherwise satisfies the definition of a charitable remainder trust.

(2) *Transfers to pre-1970 trusts.* Property transferred to a trust created (within the meaning of applicable local law) before August 1, 1969, whose governing instrument provides that an organization described in section 170(c) receives an irrevocable remainder interest in such trust, shall, for purposes of subparagraphs (1) and (3) of this paragraph, be deemed transferred to a trust created on the date of such transfer provided that the transfer occurs after July 31, 1969, and prior to October 18, 1971, and the transferred property and any undistributed income therefrom is severed and placed in a separate trust before December 31, 1972, or if later, on or before the 30th day after the date on which any judicial proceedings begun before December 31, 1972, which are required to sever such property, become final.

(3) *Amendment of post-1969 trusts.* A trust created (within the meaning of applicable local law) subsequent to July 31, 1969, and prior to December 31, 1972, which is not a charitable remainder trust at the date of its creation, may be treated as a charitable remainder trust from the date it would be deemed created under § 1.664-1(a) (4) and (5)(i) for all purposes: *Provided,* That all the following requirements are met:

(i) At the time of the creation of the trust, the governing instrument provides that an organization described in section 170(c) receives an irrevocable remainder interest in such trust.

(ii) The governing instrument of the trust is amended so that the trust will meet the definition of a charitable remainder trust and, if applicable, will meet the requirement of paragraph (a)(5)(i) of this section that obligation to make payment of the annuity or unitrust amount with respect to property passing at death begin as of the date of death, before December 31, 1972, or if later, on or before the 30th day after the date on which any judicial proceedings which are begun before December 31, 1972, and which are required to amend its governing instrument, become final. In the case of a trust created (within the meaning of applicable local law) subsequent to July 31, 1969, and prior to December 31, 1972, the provisions of section 508(d)(2)(A) shall not

apply if the governing instrument of the trust is amended so as to comply with the requirements of section 508(e) before December 31, 1972, or if later, on or before the 30th day after the date on which any judicial proceedings which are begun before December 31, 1972, and which are required to amend its governing instrument, become final. Notwithstanding the provisions of paragraphs (a)(3) and (a)(4) of §§1.664-2 and 1.664-3, the governing instrument may grant to the trustee a power to amend the governing instrument for the sole purpose of complying with the requirements of this section and §1.664-2 or §1.664-3: *Provided*, That at the creation of the trust, the governing instrument (a) provides for the payment of a unitrust amount described in §1.664-3(a)(1)(i) or an annuity which meets the requirements of paragraph (a)(2) of §1.664-2 or §1.664-3, (b) designates the recipients of the trust and the period for which the amount described in (a) of this subdivision (ii) is to be paid, and (c) provides that an organization described in section 170(c) receives an irrevocable remainder interest in such trust. The mere granting of such a power is not sufficient to meet the requirements of this subparagraph that the governing instrument be amended in the manner and within the time limitations of this subparagraph.

(iii)(a) Where the amount of the distributions which would have been made by the trust to a recipient if the amended provisions of such trust had been in effect from the time of creation of such trust exceeds the amount of the distributions made by the trust prior to its amendment, the trust pays an amount equal to such excess to the recipient.

(b) Where the amount of distributions made to the recipient prior to the amendment of the trust exceeds the amount of the distributions which would have been made by such trust if the amended provisions of such trust had been in effect from the time of creation of such trust, such excess is repaid to the trust by the recipient.

See paragraph (d)(4) of this section for rules relating to the year of inclusion in the case of an underpayment to a recipient and the allowance of a deduction in the case of an overpayment to

a recipient. A deduction for a transfer to a charitable remainder trust shall not be allowed until the requirements of this paragraph are met and then only if the deduction is claimed on a timely filed return (including extensions) or on a claim for refund filed within the period of limitations prescribed by section 6511(a).

(4) *Valuation of unmarketable assets.* The rules contained in paragraph (a)(7) of this section are applicable for trusts created on or after December 10, 1998. A trust in existence as of December 10, 1998, whose governing instrument requires that an independent trustee value the trust's unmarketable assets may be amended or reformed to permit a valuation method that satisfies the requirements of paragraph (a)(7) of this section for taxable years beginning on or after December 10, 1998.

(g) *Transitional effective date.* Notwithstanding any other provision of this section, §1.664-2 or §1.664-3, the requirement of paragraph (a)(5)(i) of this section that interest accrue on overpayments and underpayments, the requirement of paragraph (a)(5)(ii) of this section that the unitrust amount accruing under the formula provided therein cease with the death of the last recipient, and the requirement that the governing instrument of the trust contain the provisions specified in paragraph (a)(1)(iv) of §1.664-2 (relating to computation of the annuity amount in certain circumstances), paragraph (a)(1)(v) of §1.664-3 (relating to computation of the unitrust amount in certain circumstances), paragraphs (b) of §§1.664-2 and 1.664-3 (relating to additional contributions), and paragraph (a)(1)(iii) of §1.664-3 (relating to incorrect valuations), paragraphs (a)(6)(iv) of §§1.664-2 and 1.664-3 (relating to alternative remaindermen) shall not apply to:

(1) A will executed on or before December 31, 1972, if:

(i) The testator dies before December 31, 1975, without having republished the will after December 31, 1972, by codicil or otherwise.

(ii) The testator at no time after December 31, 1972, had the right to change the provisions of the will which pertain to the trust, or

(iii) The will is not republished by codicil or otherwise before December 31, 1975, and the testator is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise, or

(2) A trust executed on or before December 31, 1972, if:

(i) The grantor dies before December 31, 1975, without having amended the trust after December 31, 1972,

(ii) The trust is irrevocable on December 31, 1972, or

(iii) The trust is not amended before December 31, 1975, and the grantor is on such date and at all times thereafter under a mental disability to change the terms of the trust.

[T.D. 7202, 37 FR 16913, Aug. 23, 1972; 37 FR 28288, Dec. 22, 1972, as amended by T.D. 7955, 49 FR 19983, May 11, 1984; T.D. 8540, 59 FR 30102, 30116, June 10, 1994; T.D. 8791, 63 FR 68191, Dec. 10, 1998; T.D. 8819, 64 FR 23228, 23229, Apr. 30, 1999; T.D. 8886, 65 FR 36943, June 12, 2000; T.D. 8926, 66 FR 1037, Jan. 5, 2001]

**§ 1.664-2 Charitable remainder annuity trust.**

(a) *Description.* A charitable remainder annuity trust is a trust which complies with the applicable provisions of § 1.664-1 and meets all of the following requirements:

(1) *Required payment of annuity amount—(i) Payment of sum certain at least annually.* The governing instrument provides that the trust will pay a sum certain not less often than annually to a person or persons described in paragraph (a)(3) of this section for each taxable year of the period specified in paragraph (a)(5) of this section.

(a) *General rule applicable to all trusts.* A trust will not be deemed to have engaged in an act of self-dealing (within the meaning of section 4941), to have unrelated debt-financed income (within the meaning of section 514), to have received an additional contribution (within the meaning of paragraph (b) of this section), or to have failed to function exclusively as a charitable remainder trust (within the meaning of § 1.664-1(a)(4)) merely because the annuity amount is paid after the close of the taxable year if such payment is made within a reasonable time after the close of such taxable year and the entire annuity amount in the hands of

the recipient is characterized only as income from the categories described in section 664(b)(1), (2), or (3), except to the extent it is characterized as corpus described in section 664(b)(4) because—

(1) The trust pays the annuity amount by distributing property (other than cash) that it owned at the close of the taxable year to pay the annuity amount, and the trustee elects to treat any income generated by the distribution as occurring on the last day of the taxable year in which the annuity amount is due;

(2) The trust pays the annuity amount by distributing cash that was contributed to the trust (with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522); or

(3) The trust pays the annuity amount by distributing cash received as a return of basis in any asset that was contributed to the trust (with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522), and that is sold by the trust during the year for which the annuity amount is due.

(b) *Special rule for trusts created before December 10, 1998.* In addition to the circumstances described in paragraph (a)(1)(i)(a) of this section, a trust created before December 10, 1998, will not be deemed to have engaged in an act of self-dealing (within the meaning of section 4941), to have unrelated debt-financed income (within the meaning of section 514), to have received an additional contribution (within the meaning of paragraph (b) of this section), or to have failed to function exclusively as a charitable remainder trust (within the meaning of § 1.664-1(a)(4)) merely because the annuity amount is paid after the close of the taxable year if such payment is made within a reasonable time after the close of such taxable year and the sum certain to be paid each year as the annuity amount is 15 percent or less of the initial net fair market value of the property irrevocably passing in trust as determined for federal tax purposes.

(c) *Reasonable time.* For this paragraph (a)(1)(i), a reasonable time will not ordinarily extend beyond the date by which the trustee is required to file