

person such an accumulation distribution is "thrown back," in inverse order, to each of the preceding years to which the Internal Revenue Code of 1954 applies. That is, an accumulation distribution will be taxed to the beneficiaries of the trust in the year the distribution is made or required, but, in general, only to the extent of the distributable net income of those years which was not in fact distributed. However, with respect to a distribution by a trust other than a foreign trust created by a U.S. person, the resulting tax will not be greater than the aggregate of the taxes that would have been attributable to the amount thrown back to previous years had they been included in gross income of the beneficiaries in those years. In the case of a foreign trust created by a U.S. person, the resulting tax is computed under the provisions of section 669. To prevent double taxation, both in the case of a foreign trust created by a U.S. person, and a trust other than a foreign trust created by a U.S. person, the beneficiaries receive a credit for any taxes previously paid by the trust which are attributable to the excess thrown back and which are creditable under the provisions of chapter 1 of the Internal Revenue Code. Subpart D does not apply to any estate.

[T.D. 6989, 34 FR 733, Jan. 17, 1969]

§ 1.665(a)-1 Undistributed net income.

(a) The term *undistributed net income* means for any taxable year the distributable net income of the trust for that year as determined under section 643(a), less:

(1) The amount of income required to be distributed currently and any other amounts properly paid or credited or required to be distributed to beneficiaries in the taxable year as specified in paragraphs (1) and (2) of section 661(a), and

(2) The amount of taxes imposed on the trust, as defined in § 1.665(d)-1.

The application of the rule in this paragraph to the first year of a trust in which income is accumulated may be illustrated by the following example:

Example. Assume that under the terms of the trust, \$10,000 of income is required to be distributed currently to A and the trustee has discretion to make additional distribu-

tions to A. During the taxable year 1954 the trust had distributable net income of \$30,100 derived from royalties and the trustee made distributions of \$20,000 to A. The taxable income of the trust is \$10,000 on which a tax of \$2,640 is paid. The undistributed net income of the trust as of the close of the taxable year 1954 is \$7,460 computed as follows:

Distributable net income	\$30,100
Less:	
Income currently distributable to	
A	\$10,000
Other amounts distributed to A ..	10,000
Taxes imposed on the trust (see	
§ 1.665(d)-1)	2,640
	22,640
Undistributed net income	7,460

See also paragraphs (e)(1) and (f)(1) of § 1.668(b)-2 for additional illustrations of the application of the rule in this paragraph to the first year of a trust in which income is accumulated.

(b) The undistributed net income of a foreign trust created by a U.S. person for any taxable year is the distributable net income of such trust (see § 1.643(a)-6 and the examples set forth in paragraph (b) thereof), less:

(1) The amount of income required to be distributed currently and any other amounts properly paid or credited or required to be distributed to beneficiaries in the taxable year as specified in paragraphs (1) and (2) of section 661(a), and

(2) The amount of taxes imposed on such trust by chapter 1 of the Internal Revenue Code, which are attributable to items of income which are required to be included in such distributable net income. For purposes of subparagraph (2) of this paragraph, the amount of taxes imposed on the trust (for any taxable year), by chapter 1 of the Internal Revenue Code is the amount of taxes imposed pursuant to the provisions of section 871 which is properly allocable to the undistributed portion of the distributable net income. See § 1.665(d)-1. The amount of taxes imposed pursuant to the provisions of section 871 is the difference between the total tax imposed pursuant to the provisions of that section on the foreign trust created by a U.S. person for the year and the amount which would have been imposed on such trust had all the distributable net income, as determined under section 643(a), been distributed. The application of the rule in

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this paragraph may be illustrated by the following examples:

Example 1. A trust was created in 1952 under the laws of Country X by the transfer to a trustee in Country X of money or property by a U.S. person. The entire trust constitutes a foreign trust created by a U.S. person. The governing instrument of the trust provides that \$7,000 of income is required to be distributed currently to a U.S. beneficiary and gives the trustee discretion to make additional distributions to the beneficiary. During the taxable year 1963 the trust had income of \$10,000 from dividends of a U.S. corporation (on which Federal income taxes of \$3,000 were imposed pursuant to the provisions of section 871 and withheld under section 1441 resulting in the receipt by the trust of cash in the amount of \$7,000), \$20,000 in capital gains from the sale of stock of a Country Y corporation, and \$30,000 from dividends of a Country X corporation, none of the gross income of which was derived from sources within the United States. The trustee did not file a U.S. income tax return for the taxable year 1963. The distributable net income of the trust before distributions to the beneficiary for 1963 is \$60,000 (\$57,000 of which is cash). During 1963 the trustee made distributions to the U.S. beneficiary equaling one-half of the trust's distributable net income or \$30,000. Thus, the U.S. beneficiary is treated as having had distributed to him \$5,000 (composed of \$3,500 as a cash distribution and \$1,500 as the tax imposed pursuant to the provisions of section 871 and withheld under section 1441), representing one-half of the income from U.S. sources; \$10,000 in cash, representing one-half of the capital gains from the sale of stock of the Country Y corporation; and \$15,000 in cash, representing one-half of the income from Country X sources for a total of \$30,000. The undistributed net income of the trust at the close of taxable year 1963 is \$28,500 computed as follows:

Distributable net income	\$60,000
Less:	
(1) Amounts distributed to the beneficiary—	
Income currently distributed to the beneficiary	\$7,000
Other amounts distributed to the beneficiary	21,500
Taxes under sec. 871 deemed distributed to the beneficiary ...	1,500
Total amounts distributed to the beneficiary	30,000
(2) Amount of taxes imposed on the trust under chapter 1 of the Code (See § 1.665(d)-1) ..	1,500
Total	31,500
Undistributed net income	28,500

Example 2. The facts are the same as in example 1 except that property has been trans-

ferred to the trust by a person other than a U.S. person, and during 1963 the foreign trust created by a U.S. person was 60 percent of the entire foreign trust. The trustee paid no income taxes to Country X in 1963.

(1) The undistributed net income of the foreign trust created by a U.S. person for 1963 is \$17,100, computed as follows:

Distributable net income (60% of each item of gross income of entire trust):	
60% of \$10,000 U.S. dividends	\$6,000
60% of \$20,000 Country X capital gains	12,000
60% of \$30,000 Country X dividends	18,000
Total	36,000
Less:	
(i) Amounts distributed to the beneficiary—	
Income currently distributed to the beneficiary (60% of \$7,000)	\$4,200
Other amounts distributed to the beneficiary (60% of \$21,500) ..	12,900
Taxes under sec. 871 deemed distributed to the beneficiary (60% of \$1,500)	900
Total amounts distributed to the beneficiary	18,000
(ii) Amount of taxes imposed on the trust under chapter 1 of the Code (See § 1.665(d)-1) (60% of \$1,500)	900
Total	\$18,900
Undistributed net income	17,100

(2) The undistributed net income of the portion of the entire trust which is not a foreign trust created by a U.S. person for 1963 is \$11,400, computed as follows:

Distributed net income (40% of each item of gross income of entire trust)	
40% of \$10,000 U.S. dividends	\$4,000
40% of \$20,000 Country X capital gains	8,000
40% of Country X dividends	12,000
Total	24,000
Less:	
(i) Amounts distributed to the beneficiary—	
Income currently distributed to the beneficiary (40% of \$7,000)	\$2,800
Other amounts distributed to the beneficiary (40% of \$21,500) ..	8,600
Taxes under sec. 871 deemed distributed to the beneficiary (40% of \$1,500)	600
Total amounts distributed to the beneficiary	12,000
(ii) Amount of taxes imposed on the trust under chapter 1 of the Code (See § 1.665(d)-1) (40% of \$1,500)	\$600
Total	\$12,600
Undistributed net income	11,400

(c) However, the undistributed net income for any year to which an accumulation distribution for a later year may

be thrown back may be reduced by accumulation distributions in intervening years and also by any taxes imposed on the trust which are deemed to be distributed under section 666 by reason of the accumulation distributions. On the other hand, undistributed net income for any year will not be reduced by any distributions in an intervening year which are excluded from the definition of an accumulation distribution under section 665(b), or which are excluded under section 663(a)(1), relating to gifts, bequests, etc. See paragraph (f)(5) of § 1.668(b)-2 for an illustration of the reduction of undistributed net income for any year by a subsequent accumulation distribution.

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§ 1.665(b)-1 Accumulation distributions of trusts other than certain foreign trusts; in general.

(a) Subject to the limitations set forth in § 1.665(b)-2, in the case of a trust other than a foreign trust created by a U.S. person, the term *accumulation distribution* for any taxable year means an amount (if in excess of \$2,000), by which the amounts properly paid, credited, or required to be distributed within the meaning of section 661(a)(2) for that year exceed the distributable net income (determined under section 643(a)) of the trust, reduced (but not below zero) by the amount of income required to be distributed currently. (In computing the amount of an accumulation distribution pursuant to the preceding sentence, there is taken into account amounts applied or distributed for the support of a dependent under the circumstances specified in section 677(b) or section 678(c) out of corpus or out of other than income for the taxable year and amounts used to discharge or satisfy any person's legal obligation as that term is used in § 1.662(a)-4.) If the distribution as so computed is \$2,000 or less, it is not an accumulation distribution within the meaning of subpart D (section 665 and following), part I, subchapter J, chapter 1 of the Code. If the distribution exceeds \$2,000, then the full amount is an accumulation distribution for the purposes of subpart D.

(b) Although amounts properly paid, credited, or required to be distributed

under section 661(a)(2) do not exceed the income of the trust during the taxable year, an accumulation distribution may result if such amounts exceed distributable net income reduced (but not below zero) by the amount required to be distributed currently. This may result from the fact that expenses allocable to corpus are taken into account in determining taxable income and hence distributable net income. However, in the case of a trust other than a foreign trust created by a U.S. person, the provisions of subpart D will not apply unless there is undistributed net income in at least one of the five preceding taxable years. See section 666 and the regulations thereunder.

(c) The provisions of paragraphs (a) and (b) of this section may be illustrated by the following examples (it is assumed in each case that the exclusions provided in § 1.665(b)-2 do not apply):

Example 1. A trustee properly makes a distribution to a beneficiary of \$20,000 during the taxable year 1956, of which \$10,000 is income required to be distributed currently to the beneficiary. The distributable net income of the trust is \$15,000. There is an accumulation distribution of \$5,000 computed as follows:

Total distribution	\$20,000
Less: Income required to be distributed currently (section 661(a)(1))	10,000
Other amounts distributed (section 661(a)(2))	10,000
Distributable net income	\$15,000
Less: Income required to be distributed currently	10,000
Balance of distributable net income	5,000
Accumulation distribution	5,000

Example 2. Under the terms of the trust instrument, an annuity of \$15,000 is required to be paid to A out of income each year and the trustee may in his discretion make distributions out of income or corpus to B. During the taxable year the trust had income of \$18,000, as defined in section 643(b), and expenses allocable to corpus of \$5,000. Distributable net income amounted to \$13,000. The trustee distributed \$15,000 of income to A and in the exercise of his discretion, paid \$5,000 to B. There is an accumulation distribution of \$5,000 computed as follows:

Total distribution	\$20,000
Less: Income required to be distributed currently to A (section 661(a)(1))	15,000
Other amounts distributed (section 661(a)(2))	5,000
Distributable net income	\$13,000