

trustees which are excepted if at least half the trustees are independent, and if the grantor is not a trustee. Section 674(d) describes a further power which is excepted if it is held by trustees other than the grantor or his spouse (if living with the grantor).

(b) In general terms the grantor is treated as the owner of a portion of a trust if he or a nonadverse party or both has a power to dispose of the beneficial enjoyment of the corpus or income unless the power is one of the following:

(1) *Miscellaneous powers over either ordinary income or corpus.* (i) A power that can only affect the beneficial enjoyment of income (including capital gains) received after a period of time such that the grantor would not be treated as an owner under section 673 if the power were a reversionary interest (section 674(b)(2));

(ii) A testamentary power held by anyone (other than a testamentary power held by the grantor over accumulated income) (section 674(b)(3));

(iii) A power to choose between charitable beneficiaries or to affect the manner of their enjoyment of a beneficial interest (section 674(b)(4));

(iv) A power to allocate receipts and disbursements between income and corpus (section 674(b)(8)).

(2) *Powers of distribution primarily affecting only one beneficiary.* (i) A power to distribute corpus to or for a current income beneficiary, if the distribution must be charged against the share of corpus from which the beneficiary may receive income (section 674(b)(5)(B));

(ii) A power to distribute income to or for a current income beneficiary or to accumulate it either (a) if accumulated income must either be payable to the beneficiary from whom it was withheld or as described in paragraph (b)(6) of § 1.674(b)-1 (section 674(b)(6)); (b) if the power is to apply income to the support of a dependent of the grantor, and the income is not so applied (section 674(b)(1)); or (c) if the beneficiary is under 21 or under a legal disability and accumulated income is added to corpus (section 674(b)(7)).

(3) *Powers of distribution affecting more than one beneficiary.* A power to distribute corpus or income to or among one or more beneficiaries or to accu-

mulate income, either (i) if the power is held by a trustee or trustees other than the grantor, at least half of whom are independent (section 674(c)), or (ii) if the power is limited by a reasonably definite standard in the trust instrument, and in the case of a power over income, if in addition the power is held by a trustee or trustees other than the grantor and the grantor's spouse living with the grantor (section 674(b)(5)(A) and (d)). (These powers include both powers to "sprinkle" income or corpus among current beneficiaries, and powers to shift income or corpus between current beneficiaries and remaindermen; however, certain of the powers described under subparagraph (2) of this paragraph can have the latter effect incidentally.)

(c) See section 671 and §§ 1.671-2 and 1.671-3 for rules for the treatment of income, deductions, and credits when a person is treated as the owner of all or only a portion of a trust.

§ 1.674(b)-1 Excepted powers exercisable by any person.

(a) Paragraph (b) (1) through (8) of this section sets forth a number of powers which may be exercisable by any person without causing the grantor to be treated as an owner of a trust under section 674(a). Further, with the exception of powers described in paragraph (b)(1) of this section, it is immaterial whether these powers are held in the capacity of trustee. It makes no difference under section 674(b) that the person holding the power is the grantor, or a related or subordinate party (with the qualifications noted in paragraph (b) (1) and (3) of this section).

(b) The exceptions referred to in paragraph (a) of this section are as follows (see, however, the limitations set forth in § 1.674(d)-2):

(1) *Powers to apply income to support of a dependent.* Section 674(b)(1) provides, in effect, that regardless of the general rule of section 674(a), the income of a trust will not be considered as taxable to the grantor merely because in the discretion of any person (other than a grantor who is not acting as a trustee or cotrustee) it may be used for the support of a beneficiary whom the grantor is legally obligated to support, except to the extent that it is in fact

used for that purpose. See section 677(b) and the regulations thereunder.

(2) *Powers affecting beneficial enjoyment only after a period.* Section 674(b)(2) provides an exception to section 674(a) if the exercise of a power can only affect the beneficial enjoyment of the income of a trust received after a period of time which is such that a grantor would not be treated as an owner under section 673 if the power were a reversionary interest. See §§ 1.673(a)-1 and 1.673(b)-1. For example, if a trust created on January 1, 1955, provides for the payment of income to the grantor's son, and the grantor reserves the power to substitute other beneficiaries of income or corpus in lieu of his son on or after January 1, 1965, the grantor is not treated under section 674 as the owner of the trust with respect to ordinary income received before January 1, 1965. But the grantor will be treated as an owner on and after that date unless the power is relinquished. If the beginning of the period during which the grantor may substitute beneficiaries is postponed, the rules set forth in § 1.673(d)-1 are applicable in order to determine whether the grantor should be treated as an owner during the period following the postponement.

(3) *Testamentary powers.* Under paragraph (3) of section 674(b) a power in any person to control beneficial enjoyment exercisable only by will does not cause a grantor to be treated as an owner under section 674(a). However, this exception does not apply to income accumulated for testamentary disposition by the grantor or to income which may be accumulated for such distribution in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party. For example, if a trust instrument provides that the income is to be accumulated during the grantor's life and that the grantor may appoint the accumulated income by will, the grantor is treated as the owner of the trust. Moreover, if a trust instrument provides that the income is payable to another person for his life, but the grantor has a testamentary power of appointment over the remainder, and under the trust instrument and local law capital gains are added to corpus,

the grantor is treated as the owner of a portion of the trust and capital gains and losses are included in that portion. (See § 1.671-3.)

(4) *Powers to determine beneficial enjoyment of charitable beneficiaries.* Under paragraph (4) of section 674(b) a power in any person to determine the beneficial enjoyment of corpus or income which is irrevocably payable (currently or in the future) for purposes specified in section 170(c) (relating to definition of charitable contributions) will not cause the grantor to be treated as an owner under section 674(a). For example, if a grantor creates a trust, the income of which is irrevocably payable solely to educational or other organizations that qualify under section 170(c), he is not treated as an owner under section 674 although he retains the power to allocate the income among such organizations.

(5) *Powers to distribute corpus.* Paragraph (5) of section 674(b) provides an exception to section 674(a) for powers to distribute corpus, subject to certain limitations, as follows:

(i) If the power is limited by a reasonably definite standard which is set forth in the trust instrument, it may extend to corpus distributions to any beneficiary or beneficiaries or class of beneficiaries (whether income beneficiaries or remaindermen) without causing the grantor to be treated as an owner under section 674. See section 674(b)(5)(A). It is not required that the standard consist of the needs and circumstances of the beneficiary. A clearly measurable standard under which the holder of a power is legally accountable is deemed a reasonably definite standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; or to enable him to maintain his accustomed standard of living; or to meet an emergency, would be limited by a reasonably definite standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not limited by a reasonably definite standard. The entire context of a provision of a trust instrument granting a power must be considered in

determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no reasonably definite standard exists.

(ii) If the power is not limited by a reasonably definite standard set forth in the trust instrument, the exception applies only if distributions of corpus may be made solely in favor of current income beneficiaries, and any corpus distribution to the current income beneficiary must be chargeable against the proportionate part of corpus held in trust for payment of income to that beneficiary as if it constituted a separate trust (whether or not physically segregated). See section 674(b)(5)(B).

(iii) This subparagraph may be illustrated by the following examples:

Example 1. A trust instrument provides for payment of the income to the grantor's two brothers for life, and for payment of the corpus to the grantor's nephews in equal shares. The grantor reserves the power to distribute corpus to pay medical expenses that may be incurred by his brothers or nephews. The grantor is not treated as an owner by reason of this power because section 674(b)(5)(A) excepts a power, exercisable by any person, to invade corpus for any beneficiary, including a remainderman, if the power is limited by a reasonably definite standard which is set forth in the trust instrument. However, if the power were also exercisable in favor of a person (for example, a sister) who was not otherwise a beneficiary of the trust, section 674(b)(5)(A) would not be applicable.

Example 2. The facts are the same as in example 1 except that the grantor reserves the power to distribute any part of the corpus to his brothers or to his nephews for their happiness. The grantor is treated as the owner of the trust. Paragraph (5)(A) of section 674(b) is inapplicable because the power is not limited by a reasonably definite standard. Paragraph (5)(B) is inapplicable because the power to distribute corpus permits a distribution of corpus to persons other than current income beneficiaries.

Example 3. A trust instrument provides for payment of the income to the grantor's two adult sons in equal shares for 10 years, after which the corpus is to be distributed to his grandchildren in equal shares. The grantor reserves the power to pay over to each son up

to one-half of the corpus during the 10-year period, but any such payment shall proportionately reduce subsequent income and corpus payments made to the son receiving the corpus. Thus, if one-half of the corpus is paid to one son, all the income from the remaining half is thereafter payable to the other son. The grantor is not treated as an owner under section 674(a) by reason of this power because it qualifies under the exception of section 674(b)(5)(B).

(6) *Powers to withhold income temporarily.* (i) Section 674(b)(6) excepts a power which, in general, enables the holder merely to effect a postponement in the time when the ordinary income is enjoyed by a current income beneficiary. Specifically, there is excepted a power to distribute or apply ordinary income to or for a current income beneficiary or to accumulate the income, if the accumulated income must ultimately be payable either:

(a) To the beneficiary from whom it was withheld, his estate, or his appointees (or persons designated by name, as a class, or otherwise as alternate takers in default of appointment) under a power of appointment held by the beneficiary which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate (section 674(b)(6)(A));

(b) To the beneficiary from whom it was withheld, or if he does not survive a date of distribution which could reasonably be expected to occur within his lifetime, to his appointees (or alternate takers in default of appointment) under any power of appointment, general or special, or if he has no power of appointment to one or more designated alternate takers (other than the grantor or of the grantor's estate) whose shares have been irrevocably specified in the trust instrument (section 674(b)(6)(A) and the flush material following); or

(c) On termination of the trust, or in conjunction with a distribution of corpus which is augmented by the accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument, or if any beneficiary does not survive a date of distribution which would reasonably be expected to occur within his lifetime, to his appointees (or alternate takers in default

of appointment) under any power of appointment, general or special, or if he has no power of appointment to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified in the trust instrument (section 674(b)(6)(B) and the flush material following).

(In the application of (a) of this subdivision, if the accumulated income of a trust is ultimately payable to the estate of the current income beneficiary or is ultimately payable to his appointees or takers in default of appointment, under a power of the type described in (a) of this subdivision, it need not be payable to the beneficiary from whom it was withheld under any circumstances. Furthermore, if a trust otherwise qualifies for the exception in (a) of this subdivision the trust income will not be considered to be taxable to the grantor under section 677 by reason of the existence of the power of appointment referred to in (a) of this subdivision.) In general, the exception in section 674(b)(6) is not applicable if the power is in substance one to shift ordinary income from one beneficiary to another. Thus, a power will not qualify for this exception if ordinary income may be distributed to beneficiary A, or may be added to corpus which is ultimately payable to beneficiary B, a remainderman who is not a current income beneficiary. However, section 674(b)(6)(B), and (c) of this subdivision, permit a limited power to shift ordinary income among current income beneficiaries, as illustrated in example 1 of this subparagraph.

(ii) The application of section 674(b)(6) may be illustrated by the following examples:

Example 1. A trust instrument provides that the income shall be paid in equal shares to the grantor's two adult daughters but the grantor reserves the power to withhold from either beneficiary any part of that beneficiary's share of income and to add it to the corpus of the trust until the younger daughter reaches the age of 30 years. When the younger daughter reaches the age of 30, the trust is to terminate and the corpus is to be divided equally between the two daughters or their estates. Although exercise of this power may permit the shifting of accumulated income from one beneficiary to the other (since the corpus with the accumula-

tions is to be divided equally) the power is excepted under section 674(b)(6)(B) and subdivision (i)(c) of this subparagraph.

Example 2. The facts are the same as in example 1, except that the grantor of the trust reserves the power to distribute accumulated income to the beneficiaries in such shares as he chooses. The combined powers are not excepted by section 674(b)(6)(B) since income accumulated pursuant to the first power is neither required to be payable only in conjunction with a corpus distribution nor required to be payable in shares specified in the trust instrument. See, however, section 674(c) and § 1.674(c)-1 for the effect of such a power if it is exercisable only by independent trustees.

Example 3. A trust provides for payment of income to the grantor's adult son with the grantor retaining the power to accumulate the income until the grantor's death, when all accumulations are to be paid to the son. If the son predeceases the grantor, all accumulations are, at the death of the grantor, to be paid to his daughter, or if she is not living, to alternate takers (which do not include the grantor's estate) in specified shares. The power is excepted under section 674(b)(6)(A) since the date of distribution (the date of the grantor's death) may, in the usual case, reasonably be expected to occur during the beneficiary's (the son's) lifetime. It is not necessary that the accumulations be payable to the son's estate or his appointees if he should predecease the grantor for this exception to apply.

(7) *Power to withhold income during disability.* Section 674(b)(7) provides an exception for a power which, in general, will permit ordinary income to be withheld during the legal disability of an income beneficiary or while he is under 21. Specifically, there is excepted a power, exercisable only during the existence of a legal disability of any current income beneficiary or the period during which any income beneficiary is under the age of 21 years, to distribute or apply ordinary income to or for that beneficiary or to accumulate the income and add it to corpus. To qualify under this exception it is not necessary that the income ultimately be payable to the income beneficiary from whom it was withheld, his estate, or his appointees; that is, the accumulated income may be added to corpus and ultimately distributed to others. For example, the grantor is not treated as an owner under section 674 if the income of a trust is payable to his son for life, remainder to his grandchildren, although he reserves the

power to accumulate income and add it to corpus while his son is under 21.

(8) *Powers to allocate between corpus and income.* Paragraph (8) of section 674(b) provides that a power to allocate receipts and disbursements between corpus and income, even though expressed in broad language, will not cause the grantor to be treated as an owner under the general rule of section 674(a).

§ 1.674(c)-1 Excepted powers exercisable only by independent trustees.

Section 674(c) provides an exception to the general rule of section 674(a) for certain powers that are exercisable by independent trustees. This exception is in addition to those provided for under section 674(b) which may be held by any person including an independent trustee. The powers to which section 674(c) apply are powers (a) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, or (b) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries). In order for such a power to fall within the exception of section 674(c) it must be exercisable solely (without the approval or consent of any other person) by a trustee or trustees none of whom is the grantor and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor. (See section 672(c) for definitions of these terms.) An example of the application of section 674(c) is a trust whose income is payable to the grantor's three adult sons with power in an independent trustee to allocate without restriction the amounts of income to be paid to each son each year. Such a power does not cause the grantor to be treated as the owner of the trust. See however, the limitations set forth in § 1.674(d)-2.

§ 1.674(d)-1 Excepted powers exercisable by any trustee other than grantor or spouse.

Section 674(d) provides an additional exception to the general rule of section 674(a) for a power to distribute, apportion, or accumulate income to or for a

beneficiary or beneficiaries or to, for, or within a class of beneficiaries, whether or not the conditions of section 674(b) (6) or (7) are satisfied, if the power is solely exercisable (without the approval or consent of any other person) by a trustee or trustees none of whom is the grantor or spouse living with the grantor, and if the power is limited by a reasonably definite external standard set forth in the trust instrument (see paragraph (b)(5) of § 1.674(b)-1 with respect to what constitutes a reasonably definite standard). See, however, the limitations set forth in § 1.674(d)-2.

§ 1.674(d)-2 Limitations on exceptions in section 674 (b), (c), and (d).

(a) *Power to remove trustee.* A power in the grantor to remove, substitute, or add trustees (other than a power exercisable only upon limited conditions which do not exist during the taxable year, such as the death or resignation of, or breach of fiduciary duty by, an existing trustee) may prevent a trust from qualifying under section 674 (c) or (d). For example, if a grantor has an unrestricted power to remove an independent trustee and substitute any person including himself as trustee, the trust will not qualify under section 674 (c) or (d). On the other hand if the grantor's power to remove, substitute, or add trustees is limited so that its exercise could not alter the trust in a manner that would disqualify it under section 674 (c) or (d), as the case may be, the power itself does not disqualify the trust. Thus, for example, a power in the grantor to remove or discharge an independent trustee on the condition that he substitute another independent trustee will not prevent a trust from qualifying under section 674(c).

(b) *Power to add beneficiaries.* The exceptions described in section 674 (b) (5), (6), and (7), (c), and (d), are not applicable if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where the action is to provide for after-born or after-adopted children. This limitation does not apply to a power held by a beneficiary to substitute