

§ 1.677(b)-1

26 CFR Ch. I (4-1-04 Edition)

death the corpus shall be distributed to B, an unrelated person. Except for the right to receive income, G retains no right or power which would cause him to be treated as an owner under sections 671 through 677. Under the applicable local law capital gains must be applied to corpus. During the taxable year 1970 the trust has the following items of gross income and deductions:

Dividends	\$5,000
Capital gain	1,000
Expenses allocable to income	200
Expenses allocable to corpus	100

Since G has a right to receive income he is treated as an owner of a portion of the trust under section 677. Accordingly, he should include the \$5,000 of dividends, \$200 income expense, and \$100 corpus expense in the computation of his taxable income for 1970. He should not include the \$1,000 capital gain since that is not attributable to the portion of the trust that he owns. See §1.671-3(b). The tax consequences of the capital gain are governed by the provisions of subparts A, B, C, and D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Had the trust sustained a capital loss in any amount the loss would likewise not be included in the computation of G's taxable income, but would also be governed by the provisions of such subparts.

Example 2. G creates a trust which provides that the ordinary income is payable to his adult son. Ten years and one day from the date of transfer or on the death of his son, whichever is earlier, corpus is to revert to G. In addition, G retains a discretionary right to receive \$5,000 of ordinary income each year. (Absent the exercise of this right all the ordinary income is to be distributed to his son.) G retained no other right or power which would cause him to be treated as an owner under subpart E (section 671 and following). Under the terms of the trust instrument and applicable local law capital gains must be applied to corpus. During the taxable year 1970 the trust had the following items of income and deductions:

Dividends	\$10,000
Capital gain	2,000
Expenses allocable to income	400
Expenses allocable to corpus	200

Since the capital gain is held or accumulated for future distributions to G, he is treated under section 677(a)(2) as an owner of a portion of the trust to which the gain is attributable. See §1.671-3(b).

Therefore, he must include the capital gain in the computation of his taxable income. (Had the trust sustained a capital loss in any amount, G would likewise include that loss in the computation of his taxable income.) In addition, because of G's discretionary right (whether exercised or not) he is treated as the owner of a portion of the trust which will

permit a distribution of income to him of \$5,000. Accordingly, G includes dividends of \$5,208.33 and income expenses of \$208.33 in computing his taxable income, determined in the following manner:

Total dividends	\$10,000.00
Less: Expenses allocable to income	400.00
	9,600.00
Distributable income of the trust	9,600.00
Portion of dividends attributable to G (5,000/9,600×\$10,000)	5,208.33
Portion of income expenses attributable to G (5,000/9,600×\$400)	208.33
	5,000.00
Amount of income subject to discretionary right	5,000.00

In accordance with §1.671-3(c), G also takes into account \$104.17 (5,000/9,600×\$200) of corpus expenses in computing his tax liability. The portion of the dividends and expenses of the trust not attributable to G are governed by the provisions of subparts A through D.

[T.D. 7148, 36 FR 20749, Oct. 29, 1971, as amended by T.D. 8668, 61 FR 19191, May 1, 1996]

§ 1.677(b)-1 Trusts for support.

(a) Section 677(b) provides that a grantor is not treated as the owner of a trust merely because its income may in the discretion of any person other than the grantor (except when he is acting as trustee or cotrustee) be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse in the case of income from property transferred in trust after October 9, 1969), such as the child of the grantor, whom the grantor or his spouse is legally obligated to support. If income of the current year of the trust is actually so applied or distributed the grantor may be treated as the owner of any portion of the trust under section 677 to that extent, even though it might have been applied or distributed for other purposes. In the case of property transferred to a trust before October 10, 1969, for the benefit of the grantor's spouse, the grantor may be treated as the owner to the extent income of the current year is actually applied for the support or maintenance of his spouse.

(b) If any amount applied or distributed for the support of a beneficiary, including the grantor's spouse in the case of property transferred in trust before October 10, 1969, whom the grantor is legally obligated to support is paid out of corpus or out of income

other than income of the current year, the grantor is treated as a beneficiary of the trust, and the amount applied or distributed is considered to be an amount paid within the meaning of section 661(a)(2), taxable to the grantor under section 662. Thus, he is subject to the other relevant portions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Accordingly, the grantor may be taxed on an accumulation distribution or a capital gain distribution under subpart D (section 665 and following) of such part I. Those provisions are applied on the basis that the grantor is the beneficiary.

(c) For the purpose of determining the items of income, deduction, and credit of a trust to be included under this section in computing the grantor's tax liability, the income of the trust for the taxable year of distribution will be deemed to have been first distributed. For example, in the case of a trust reporting on the calendar year basis, a distribution made on January 1, 1956, will be deemed to have been made out of ordinary income of the trust for the calendar year 1956 to the extent of the income for that year even though the trust had received no income as of January 1, 1956. Thus, if a distribution of \$10,000 is made on January 1, 1956, for the support of the grantor's dependent, the grantor will be treated as the owner of the trust for 1956 to that extent. If the trust received dividends of \$5,000 and incurred expenses of \$1,000 during that year but subsequent to January 1, he will take into account dividends of \$5,000 and expenses of \$1,000 in computing his tax liability for 1956. In addition, the grantor will be treated as a beneficiary of the trust with respect to the \$6,000 (\$10,000 less distributable income of \$4,000 (dividends of \$5,000 less expenses of \$1,000)) paid out of corpus or out of other than income of the current year. See paragraph (b) of this section.

(d) The exception provided in section 677(b) relates solely to the satisfaction of the grantor's legal obligation to support or maintain a beneficiary. Consequently, the general rule of section 677(a) is applicable when in the discretion of the grantor or nonadverse parties income of a trust may be applied

in discharge of a grantor's obligations other than his obligation of support or maintenance falling within section 677(b). Thus, if the grantor creates a trust the income of which may in the discretion of a nonadverse party be applied in the payment of the grantor's debts, such as the payment of his rent or other household expenses, he is treated as an owner of the trust regardless of whether the income is actually so applied.

(e) The general rule of section 677(a), and not section 677(b), is applicable if discretion to apply or distribute income of a trust rests solely in the grantor, or in the grantor in conjunction with other persons, unless in either case the grantor has such discretion as trustee or cotrustee.

(f) The general rule of section 677(a), and not section 677(b), is applicable to the extent that income is required, without any discretionary determination, to be applied to the support of a beneficiary whom the grantor is legally obligated to support.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7148, 36 FR 20750, Oct. 29, 1971]

§ 1.678(a)-1 Person other than grantor treated as substantial owner; general rule.

(a) Where a person other than the grantor of a trust has a power exercisable solely by himself to vest the corpus or the income of any portion of a testamentary or inter vivos trust in himself, he is treated under section 678(a) as the owner of that portion, except as provided in section 678(b) (involving taxation of the grantor) and section 678(c) (involving and obligation of support). The holder of such a power also is treated as an owner of the trust even though he has partially released or otherwise modified the power so that he can no longer vest the corpus or income in himself, if he has retained such control of the trust as would, if retained by a grantor, subject the grantor to treatment as the owner under sections 671 to 677, inclusive. See section 671 and §§ 1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit where a person is treated as the owner of all or only a portion of a trust.