

trust, and *FC* is a foreign corporation. The examples are as follows:

Example 1. Transfer treated as transfer to trust. *A* creates and funds *FT*, which is treated as having a U.S. beneficiary under § 1.679-2. *FT* owns all of the outstanding stock of *FC*. *A* transfers property directly to *FC*. Because *FT* is the sole shareholder of *FC*, *A* is unable to demonstrate to the satisfaction of the Commissioner that the transfer is properly attributable to *A*'s ownership interest in *FC*. Accordingly, under this paragraph (f), *A* is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. Under § 1.679-1(a), *A* is treated as the owner of the portion of *FT* attributable to the property treated as transferred directly to *FT*. Under § 1.367(a)-1T(c)(4)(ii), the transfer of property by *FT* to *FC* is treated as a transfer of the property by *A* to *FC*.

Example 2. Transfer treated as transfer to trust. The facts are the same as in *Example 1*, except that *FT* is not treated as having a U.S. beneficiary under § 1.679-2. Under this paragraph (f), *A* is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. *A* is not treated as the owner of *FT* for purposes of § 1.679-1(a). For rules regarding the recognition of gain on the transfer, see section 684.

Example 3. Transfer not treated as transfer to trust. *A* creates and funds *FT*. *FC* has outstanding solely 100 shares of common stock. *FT* owns 50 shares of *FC* stock, and *A* owns the remaining 50 shares. On July 1, 2001, *FT* and *A* each transfer 1000X to *FC*. *A* is able to demonstrate to the satisfaction of the Commissioner that *A*'s transfer to *FC* is properly attributable to *A*'s ownership interest in *FC*. Accordingly, under this paragraph (f), *A*'s transfer to *FC* is not treated as a transfer to *FT*.

[T.D. 8955, 66 FR 37889, July 20, 2001]

§ 1.679-4 Exceptions to general rule.

(a) *In general.* Section 1.679-1 does not apply to—

- (1) Any transfer of property to a foreign trust by reason of the death of the transferor;
- (2) Any transfer of property to a foreign trust described in sections 402(b), 404(a)(4), or 404A;
- (3) Any transfer of property to a foreign trust described in section 501(c)(3) (without regard to the requirements of section 508(a)); and
- (4) Any transfer of property to a foreign trust to the extent the transfer is for fair market value.

(b) *Transfers for fair market value—(1) In general.* For purposes of this section, a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust. For example, rents, royalties, interest, and compensation paid to a trust are transfers for fair market value only to the extent that the payments reflect an arm's length price for the use of the property of, or for the services rendered by, the trust. For purposes of this determination, an interest in the trust is not property received from the trust. For purposes of this section, a distribution to a trust with respect to an interest held by such trust in an entity other than a trust or an interest in certain investment trusts described in § 301.7701-4(c) of this chapter, liquidating trusts described in § 301.7701-4(d) of this chapter, or environmental remediation trusts described in § 301.7701-4(e) of this chapter is considered to be a transfer for fair market value.

(2) *Special rule—(i) Transfers for partial consideration.* For purposes of this section, if a person transfers property to a foreign trust in exchange for property having a fair market value that is less than the fair market value of the property transferred, the exception in paragraph (a)(4) of this section applies only to the extent of the fair market value of the property received.

(ii) *Example.* This paragraph (b) is illustrated by the following example:

Example. *A*, a U.S. citizen, transfers property that has a fair market value of 1000X to *FT*, a foreign trust, in exchange for 600X of cash. Under this paragraph (b), § 1.679-1 applies with respect to the transfer of 400X (1000X less 600X) to *FT*.

(c) *Certain obligations not taken into account.* Solely for purposes of this section, in determining whether a transfer by a U.S. transferor that is a related person (as defined in § 1.679-1(c)(5)) with respect to the foreign trust is for fair market value, any obligation (as defined in § 1.679-1(c)(6)) of the trust or a related person (as defined in § 1.679-1(c)(5)) that is not a qualified obligation within the meaning of paragraph (d)(1) of this section shall not be taken into account.

(d) *Qualified obligations*—(1) *In general.* For purposes of this section, an obligation is treated as a qualified obligation only if—

(i) The obligation is reduced to writing by an express written agreement;

(ii) The term of the obligation does not exceed five years (for purposes of determining the term of an obligation, the obligation's maturity date is the last possible date that the obligation can be outstanding under the terms of the obligation);

(iii) All payments on the obligation are denominated in U.S. dollars;

(iv) The yield to maturity is not less than 100 percent of the applicable Federal rate and not greater than 130 percent of the applicable Federal rate (the applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter));

(v) The U.S. transferor extends the period for assessment of any income or transfer tax attributable to the transfer and any consequential income tax changes for each year that the obligation is outstanding, to a date not earlier than three years after the maturity date of the obligation (this extension is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. transferor's taxable year for the year of the transfer and is paid within such period); when properly executed and filed, such an agreement is deemed to be consented to for purposes of §301.6501(c)-1(d) of this chapter; and

(vi) The U.S. transferor reports the status of the loan, including principal and interest payments, on Form 3520 for every year that the loan is outstanding.

(2) *Additional loans.* If, while the original obligation is outstanding, the U.S. transferor or a person related to the trust (within the meaning of §1.679-1(c)(5)) directly or indirectly obtains another obligation issued by the trust, or if the U.S. transferor directly or indirectly obtains another obligation issued by a person related to the trust, the original obligation is deemed to have the maturity date of any such

subsequent obligation in determining whether the term of the original obligation exceeds the specified 5-year term. In addition, a series of obligations issued and repaid by the trust (or a person related to the trust) is treated as a single obligation if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of this provision.

(3) *Obligations that cease to be qualified.* If an obligation treated as a qualified obligation subsequently fails to be a qualified obligation (e.g., renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. transferor is treated as making a transfer to the trust in an amount equal to the original obligation's adjusted issue price (within the meaning of §1.1275-1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273-1(c)) as of the date of the subsequent event that causes the obligation to no longer be a qualified obligation. If the maturity date is extended beyond five years by reason of the issuance of a subsequent obligation by the trust (or person related to the trust), the amount of the transfer will not exceed the issue price of the subsequent obligation. The subsequent obligation is separately tested to determine if it is a qualified obligation.

(4) *Transfers resulting from failed qualified obligations.* In general, a transfer resulting from a failed qualified obligation is deemed to occur on the date of the subsequent event that causes the obligation to no longer be a qualified obligation. However, based on all of the facts and circumstances, the Commissioner may deem a transfer to have occurred on any date on or after the issue date of the original obligation. For example, if at the time the original obligation was issued, the transferor knew or had reason to know that the obligation would not be repaid, the Commissioner could deem the transfer to have occurred on the issue date of the original obligation.

(5) *Renegotiated loans.* Any loan that is renegotiated, extended, or revised is treated as a new loan, and any transfer of funds to a foreign trust after such renegotiation, extension, or revision

under a pre-existing loan agreement is treated as a transfer subject to this section.

(6) *Principal repayments.* The payment of principal with respect to any obligation that is not treated as a qualified obligation under this paragraph is taken into account on and after the date of the payment in determining the portion of the trust attributable to the property transferred.

(7) *Examples.* The rules of this paragraph (d) are illustrated by the following examples. In the examples, *A* and *B* are U.S. residents and *FT* is a foreign trust. The examples are as follows:

Example 1. Demand loan. *A* transfers 500X to *FT* in exchange for a demand note that permits *A* to require repayment by *FT* at any time. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full 500X transfer to *FT*.

Example 2. Private annuity. *A* transfers 4000X to *FT* in exchange for an annuity from the foreign trust that will pay *A* 100X per year for the rest of *A*'s life. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full 4000X transfer to *FT*.

Example 3. Loan to unrelated foreign trust. *B* transfers 1000X to *FT* in exchange for an obligation of the trust. The term of the obligation is fifteen years. *B* is not a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because *B* is not a related person, the fair market value of the obligation received by *B* is taken into account for purposes of determining whether *B*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section, even though the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section.

Example 4. Transfer for an obligation with term in excess of 5 years. *A* transfers property that has a fair market value of 5000X to *FT* in exchange for an obligation of the trust. The term of the obligation is ten years. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Because the term of the obligation is greater than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full 5000X transfer to *FT*.

Example 5. Transfer for a qualified obligation. The facts are the same as in *Example 4*, except that the term of the obligation is 3 years. Assuming the other requirements of paragraph (d)(1) of this section are satisfied, the obligation is a qualified obligation and its adjusted issue price is taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section.

Example 6. Effect of subsequent obligation on original obligation. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for an obligation that satisfies the requirements of paragraph (d)(1) of this section. *A* is a related person (as defined in §1.679-1(c)(5)) with respect to *FT*. Two years later, *A* transfers an additional 2000X to *FT* and receives another obligation from *FT* that has a maturity date four years from the date that the second obligation was issued. Under paragraph (d)(2) of this section, the original obligation is deemed to have the maturity date of the second obligation. Under paragraph (a) of this section, *A* is treated as having made a transfer in an amount equal to the original obligation's adjusted issue price (within the meaning of §1.1275-1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273-1(c)) as of the date of issuance of the second obligation. The second obligation is tested separately to determine whether it is a qualified obligation for purposes of applying paragraph (a) of this section to the second transfer.

[T.D. 8955, 66 FR 37889, July 20, 2001]

§ 1.679-5 Pre-immigration trusts.

(a) *In general.* If a nonresident alien individual becomes a U.S. person and the individual has a residency starting date (as determined under section 7701(b)(2)(A)) within 5 years after directly or indirectly transferring property to a foreign trust (the original transfer), the individual is treated as having transferred to the trust on the residency starting date an amount