Internal Revenue
bulletin

Bulletin No. 2001–32
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2001–33, page 118.
Mutual life insurance companies; differential earnings rate. The differential earnings rate for 2000 and the recomputed differential earnings rate for 1999 are set forth for use by mutual life insurance companies to compute their income tax liabilities for 2000.

Rev. Rul. 2001–36, page 119.
Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for August 2001.

Rev. Rul. 2001–37, page 100.
Low-income housing credit; satisfactory bond; "bond factor" amounts for the period July through September 2001. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2001.

T.D. 8955, page 101.
Final regulations under section 679 of the Code relate to transfers of property by U.S. persons to foreign trusts having one or more beneficiaries. In addition, the regulations revise section 1.958–1, direct and indirect ownership of stock, and amend section 1.958–2, constructive ownership of stock.

T.D. 8956, page 112.
Final regulations under section 684 of the Code relate to the recognition of gain on certain transfers to certain foreign trusts and estates. The regulations affect United States persons who transfer appreciated property to foreign trusts and estates. In addition, the regulations explain the application of section 684 and provide certain exceptions to the general rule of gain recognition.

EMPLOYEE PLANS

Notice 2001–46, page 122.
Nonapplication of nondiscrimination rules; certain church and governmental plans. This notice extends the relief relating to the application of nondiscrimination rules for certain church and governmental retirement plans. Notice 2001–9 modified.

Announcement 2001–82, page 123.
This announcement provides an alternative model amendment for proposed regulations (REG–130477–00 and REG–130481–00, 2001–11 I.R.B. 865) under section 401 of the Code, which certain qualified plan sponsors may adopt if they began making required minimum distributions for 2001 based on proposed regulations published in 1987.

Finding Lists begin on page ii.
Index for July begins on page iv.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period July through September 2001. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2001.

Rev. Rul. 2001–37

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

Rev. Proc. 99–11, 1999–1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period July through September 2001.

Table 1
Rev. Rul. 2001–37
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Jul '01	19.30	35.47	49.02	60.48	70.18	70.27	71.68	72.99	74.30	75.75	77.30
Aug '01	19.30	35.47	49.02	60.48	70.18	70.09	71.49	72.80	74.10	75.55	77.10
Sep '01	19.30	35.47	49.02	60.48	70.18	69.91	71.31	72.61	73.91	75.36	76.91

Table 1 (cont'd)
Rev. Rul. 2001–37
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year			
Month of Disposition	1998	1999	2000	2001
Jul '01	79.07	80.80	82.36	83.98
Aug '01	78.86	80.60	82.19	83.98
Sep '01	78.67	80.41	82.05	83.98

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98–3, 1998–1 C.B. 248, and Rev. Rul. 2001–2, 2001–2 I.R.B. 255. For dispositions occurring during the period January through March 2001, see Rev. Rul. 2001–10, 2001–10 I.R.B. 755. For dispositions during the period April through June 2001, see Rev. Rul. 2001–19, 2001–18 I.R.B. 1143.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran at (202) 622-3040 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 679.—Foreign Trusts Having One or More United States Beneficiaries

26 CFR 1.679–2: Trusts treated as having a U. S. beneficiary.

T. D. 8955

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Foreign Trusts That Have U.S. Beneficiaries

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 679 of the Internal Revenue Code relating to transfers of property by U.S. persons to foreign trusts having one or more United States beneficiaries. The final regulations affect United States persons who transfer property to foreign trusts.

DATES: *Effective Date*: These regulations are effective July 20, 2001.

Applicability Date: For dates of applicability, see §1.679–7.

FOR FURTHER INFORMATION CONTACT: Willard W. Yates at (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 7, 2000, the IRS and Treasury published a notice of proposed rulemaking (REG–209038–89, 2000–34 I.R.B. 191) in the **Federal Register** (65 FR 48185) inviting comments relating to the treatment of U.S. persons who transfer property to foreign trusts that have one or more U.S. beneficiaries. Comments responding to the notice of proposed rulemaking were received and a public hearing was held on November 8, 2000. After consideration of all of the comments, the proposed regulations are adopted as revised by this Treasury decision. The revisions are discussed below.

Explanation of Provisions

Comments Relating to §1.679–2: Trusts Treated as Having a U.S. Beneficiary

A. *Benefit to a U.S. Person*

Under §1.679–2(a)(1) of the proposed regulations, a foreign trust that has received property from a U.S. transferor is treated as having a U.S. beneficiary unless during the taxable year of the U.S. transferor both of the following tests are satisfied: (i) no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, either directly or indirectly, a U.S. person; and (ii) if the trust is terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of, either directly or indirectly, a U.S. person.

Section 1.679–2(a)(2)(i) of the proposed regulations provides that, for purposes of applying these tests, income or corpus is considered to be paid or accumulated to or for the benefit of a U.S. person during a taxable year of the U.S. transferor if during that year, directly or indirectly, income may be distributed to, or accumulated for the benefit of a U.S. person, or corpus may be distributed to, or held for the future benefit of, a U.S. person. This determination is made without

regard to whether income or corpus is actually distributed to a U.S. person during that year, and without regard to whether a U.S. person's interest in the trust income or corpus is contingent on a future event. The proposed regulations provide a narrow exception with respect to certain contingent beneficiaries whose interests in the trust are so remote as to be negligible.

One commenter suggests that §1.679–2(a)(2) of the proposed regulations (specifically, *Example 5* of §1.679–2(a)(2)(iii)) is overly broad. The commenter suggests that a foreign trust should not be treated as having a U.S. beneficiary where the trust's only asset consists of stock of a foreign corporation, the trust will terminate one year after the death of a U.S. transferor, whereupon distributions of corpus or income may be made to a U.S. person, and the trust receives no income from the corporation during the term of its existence. The commenter argues that because the foreign trust receives no income from the foreign corporation during the trust's existence, the U.S. person's status as a beneficiary provides the U.S. person with nothing of value and, therefore, the foreign trust should not be treated as having a U.S. beneficiary.

The commenter's argument overlooks the clear legislative intent underlying section 679 that a foreign trust will be treated as having a U.S. beneficiary even in situations where there exists only the possibility of distribution of income or corpus to or the accumulation of corpus for the benefit of a U.S. person. H.R. Rep. No. 658, 94th Cong., 1st Sess., at 210 (1975). The fact that a foreign trust holds an asset, such as the stock of a foreign corporation, that produces no income during the term of the trust's existence is of no import for purposes of determining whether the trust will be treated as having a U.S. beneficiary. The determining factor in such a situation is that the trust holds corpus for the future benefit of a U.S. person, regardless of whether the corpus consists of stock with respect to which no dividends have been paid or some other asset that produces no current income. Accordingly, the final regulations adopt the rule of the proposed regulations.

B. *Records and Documents*

Section 1.679–2(a)(4) of the proposed regulations provides that a trust may be treated as having a U.S. beneficiary by reference, *inter alia*, to written and oral agreements and understandings not contained in the trust document, and to whether the terms of the trust instrument are actually or reasonably expected to be disregarded by the parties to the trust. A commenter states that this rule creates new and unclear rules for purposes of determining whether an arrangement constitutes a trust for Federal income tax purposes.

The determination as to whether an arrangement will be treated as a trust is made pursuant to the rules set forth in §301.7701–4 of the regulations. The regulations under section 679 address only the determination of whether a foreign trust will be treated as having a U.S. beneficiary. The final regulations are not intended to provide factors in addition to the rules of §301.7701–4 for purposes of determining whether an arrangement constitutes a trust for federal income tax purposes.

C. *Trusts Acquiring a U.S. Beneficiary*

The proposed regulations anticipate situations where the beneficiary of a foreign trust may change. Section 1.679–2(c)(1) of the proposed regulations provides that if a foreign trust is not treated as having a U.S. beneficiary (within the meaning of §1.679–2(a)) but subsequently is treated as having a U.S. beneficiary, the U.S. transferor is treated as having additional income in the first taxable year of the U.S. transferor in which the trust is treated as having a U.S. beneficiary. The amount of the additional income is equal to the trust's undistributed net income, as defined in section 665(a), at the end of the U.S. transferor's immediately preceding taxable year and is subject to the rules of section 668, providing for an interest charge on accumulation distributions from foreign trusts.

A commenter suggests that the rule treating the U.S. transferor as having additional income in the first year the foreign trust acquires the U.S. beneficiary exceeds the authority of section 679, noting that in most cases the transferor will not have received any income from the trust.

Section 1.679–2(c)(1) of the proposed regulations follows closely the legislative history underlying section 679 regarding the U.S. transferor's recognition of additional income. The legislative history provides that the amount of the additional income shall be the foreign trust's undistributed net income, *i.e.*, accumulated income that would be taxable to a beneficiary upon distribution, as of the close of the immediately preceding taxable year. H.R. Rep. No. 658, 94th Cong., 1st Sess., at 211, Fn. 13 (1975). In short, the legislative history provides that the U.S. transferor's additional income shall receive the same treatment as accumulation distributions to beneficiaries of a foreign trust. Accumulated income distributions to beneficiaries of foreign trusts are subject to the interest charge provided for in section 668. Accordingly, the provision for additional income in §1.679–2(c)(1) of the final regulations, as well as the application of the interest charge provided for in section 668, are necessary to carry out the legislative purpose of section 679. The rule of the proposed regulations is adopted by the final regulations without change.

Comments Relating to §1.679–3: Transfers

A. *Indirect Transfers - Principal Purpose of Tax Avoidance*

Section 1.679–3(a) of the proposed regulations broadly defines the term *transfer* as any direct, indirect, or constructive transfer by a U.S. person to a foreign trust. Section 1.679–3(c) of the proposed regulations provides rules for determining when there is an indirect transfer. Under §1.679–3(c)(1) of the proposed regulations, a transfer to a foreign trust by any person to whom a U.S. person transfers property (referred to as an intermediary) is treated as an indirect transfer by a U.S. person if the transfer is made pursuant to a plan one of the principal purposes of which is the avoidance of U.S. tax. Section 1.679–3(c)(2) of the proposed regulations deems a transfer to have been made pursuant to such a plan if certain conditions are present.

The deemed-principal-purpose test of §1.679–3(c)(2) of the proposed regulations is similar to the deemed-principal-purpose test in §1.643(h)–1(a) of the regulations, which concerns distributions from foreign trusts to U.S. persons through intermediaries, except that the presumption in the proposed regulations applies without regard to the period of time between

the transfer from the U.S. person to the intermediary and from the intermediary to the foreign trust. In contrast, the deemed-principal-purpose test of §1.643(h)–1(a)(2)(ii) applies only if property is distributed to the U.S. person during the period beginning 24 months before and ending 24 months after the intermediary's receipt of property from the foreign trust. A commenter suggests that a similar time limit should be provided in §1.679–3(c)(2) with respect to outbound transfers.

In the context of section 643(h), Treasury and the IRS weighed the potential for abuse in that area against the possible adverse effect that the deemed-principal-purpose test could have on legitimate transactions, and concluded that a time limitation in §1.643(h)–1(a)(2) was appropriate. However, Treasury and the IRS believe the potential for abuse is greater in the case of outbound transfers to foreign trusts than in the case of inbound trust distributions to U.S. beneficiaries. Congress enacted section 679 in order to prevent the tax-free accumulation of income earned by foreign trusts over long periods of time that provided foreign trusts with an unwarranted advantage over domestic trusts. H.R. Rep. No. 658, 94th Cong., 1st Sess., at 207 (1975). Providing for a time limitation to the application of §1.679–3(c) could allow for easy circumvention of Congress' purpose in enacting section 679. Treasury and the IRS recognize that some transfers that were not intended to avoid U.S. tax may come within the presumption in the absence of a specific time limit. However, under such circumstances §1.679–3(c)(2)(ii) provides taxpayers with a way to rebut the application of the deemed-principal-purpose test. Therefore, the final regulations do not include a time limitation to the application of §1.679–3(c)(2)(i).

B. *Indirect Transfers - Corporate Distributions*

One commenter asked about the application of the indirect transfer rules set forth in §1.679–3(c) of the proposed regulations to successive corporate distributions up a chain of wholly-owned corporations to an ultimate shareholder that is a foreign trust. The commenter expressed concern that, if one of the lower-tier corporations were a domestic corporation, §1.679–3(c) of the proposed regulations could potentially treat the distributions as an indirect transfer from the domestic corporation to the foreign trust that would be subject to the general rule of §1.679–1.

Even if the distributions were characterized as an indirect transfer from a domestic corporation to a foreign trust under §1.679–3(c), the indirect transfer would generally be treated as a transfer for fair market value under the final sentence of §1.679–4(b)(1) and would therefore be excepted from the general rule of §1.679–1 pursuant to §1.679–4(a)(4). Therefore, no special rules have been added to the final regulations to address this situation.

C. *Transfers to Entities Owned by Foreign Trusts*

Section 1.679–3(f) of the proposed regulations provides specific rules regarding transfers by a U.S. person to an entity owned by a foreign trust if the U.S. person is related to the foreign trust. The transfer is treated as a transfer from the U.S. person to the foreign trust, followed by a transfer from the foreign trust to the entity owned by the foreign trust, unless the U.S. person demonstrates to the satisfaction of the Commissioner that the transfer to the entity is properly attributable to the U.S. person's ownership interest in the entity. A commenter noted potential conflicts with this rule and judicial doctrines concerning constructive corporate distributions.

Section 1.679–3(f) is not intended to override judicial doctrines concerning constructive corporate distributions. For example, if judicial doctrines would recharacterize a direct transfer of property by a domestic corporation to an entity owned by a foreign trust as a constructive dividend of the property to the domestic corporation's shareholder followed by a constructive transfer of the property by that shareholder to the foreign trust and a constructive contribution by the foreign trust to the entity owned by the foreign trust, then those judicial doctrines would apply (and §1.679–3(f) would not apply) to the transaction.

Comments Relating to §1.679–4: Exceptions to General Rule - Transfers to Trusts Described in Section 501(c)(3)

Section 1.679–4(a)(3) of the proposed regulations provides an exception to the general rule of §1.679–1 for transfers to a foreign trust that has already received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3), provided that the letter has been neither revoked nor modified. Commenters questioned the requirement that a foreign trust obtain a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). They assert that the requirement may interfere with a U.S. person's ability to make contributions to a foreign charitable entity that may not be familiar with U.S. tax laws and may not have any reason to obtain a determination letter from the IRS. They suggest that the final regulations require only that the U.S. transferor disclose to the IRS, at such time and in such manner as the IRS may provide, that the transfer has been made and that the transferor believes the transferee is an organization described in section 501(c)(3).

In response to commenters' concerns, the final regulations eliminate the requirement that the foreign trust receive a ruling or determination letter from the IRS recognizing the trust's tax-exempt status under section 501(c)(3). The final regulations provide instead that the general rule of §1.679–1 does not apply to any transfer of property to a foreign trust that is described in section 501(c)(3). However, taxpayers should be aware that, under Notice 97–34 (1997–1 C.B. 422), the U.S. transferor has a reporting obligation on Form 3520 with respect to such a transfer, unless the foreign trust has received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). Moreover, if the IRS subsequently determines that the foreign trust is not described in section 501(c)(3), the exception will not apply for any taxable year of the U.S. transferor, and the U.S. transferor may be subject to interest and penalties, if applicable.

Clarification Regarding Section 958

The final regulations clarify the language of §1.958–1(b) of the proposed regulations with respect to persons who are treated as owners under sections 671 through 679 of any portion of a foreign trust that includes the stock of a foreign corporation.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these final regulations is Willard W. Yates of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.679–1 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–2 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–3 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–4 also issued under 26 U.S.C. 643(a)(7), 679(a)(3) and 679(d).

Section 1.679–5 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–6 also issued under 26 U.S.C. 643(a)(7) and 679(d). * * *

Par. 2. Sections 1.679–0, 1.679–1, 1.679–2, 1.679–3, 1.679–4, 1.679–5, 1.679–6, and 1.679–7 are added under the undesignated center heading "Grantors and Others Treated as Substantial Owners" to read as follows:

§1.679–0 Outline of major topics.

This section lists the major paragraphs contained in §§1.679–1 through 1.679–7 as follows:

§1.679–1 U.S. transferor treated as owner of foreign trust.

(a) In general.
(b) Interaction with sections 673 through 678.
(c) Definitions.
(1) U.S. transferor.
(2) U.S. person.
(3) Foreign trust.
(4) Property.
(5) Related person.
(6) Obligation.
(d) Examples.

§1.679–2 Trusts treated as having a U.S. beneficiary.

(a) Existence of U.S. beneficiary.
(1) In general.
(2) Benefit to a U.S. person.
(i) In general.
(ii) Certain unexpected beneficiaries.
(iii) Examples.
(3) Changes in beneficiary's status.
(i) In general.
(ii) Examples.
(4) General rules.
(i) Records and documents.
(ii) Additional factors.
(iii) Examples.
(b) Indirect U.S. beneficiaries.
(1) Certain foreign entities.
(2) Other indirect beneficiaries.
(3) Examples.
(c) Treatment of U.S. transferor upon foreign trust's acquisition or loss of U.S. beneficiary.
(1) Trusts acquiring a U.S. beneficiary.
(2) Trusts ceasing to have a U.S. beneficiary.
(3) Examples.

§1.679–3 Transfers.

(a) In general.
(b) Transfers by certain trusts.
(1) In general.
(2) Example.
(c) Indirect transfers.
(1) Principal purpose of tax avoidance.
(2) Principal purpose of tax avoidance deemed to exist.
(3) Effect of disregarding intermediary.
(i) In general.
(ii) Special rule.
(iii) Effect on intermediary.
(4) Related parties.
(5) Examples.
(d) Constructive transfers.
(1) In general.
(2) Examples.
(e) Guarantee of trust obligations.
(1) In general.
(2) Amount transferred.
(3) Principal repayments.
(4) Guarantee.
(5) Examples.
(f) Transfers to entities owned by a foreign trust.
(1) General rule.
(2) Examples.

§1.679–4 Exceptions to general rule.

(a) In general.
(b) Transfers for fair market value.
(1) In general.
(2) Special rule.
(i) Transfers for partial consideration.
(ii) Example.
(c) Certain obligations not taken into account.
(d) Qualified obligations.
(1) In general.
(2) Additional loans.
(3) Obligations that cease to be qualified.
(4) Transfers resulting from failed qualified obligations.
(5) Renegotiated loans.
(6) Principal repayments.
(7) Examples.

§1.679–5 Pre-immigration trusts.

(a) In general.
(b) Special rules.
(1) Change in grantor trust status.
(2) Treatment of undistributed income.
(c) Examples.

§1.679–6 Outbound migrations of domestic trusts.

(a) In general.
(b) Amount deemed transferred.

(c) Example.

§1.679–7 Effective dates.

(a) In general.
(b) Special rules.

§1.679–1 U.S. transferor treated as owner of foreign trust.

(a) *In general*. A U.S. transferor who transfers property to a foreign trust is treated as the owner of the portion of the trust attributable to the property transferred if there is a U.S. beneficiary of any portion of the trust, unless an exception in §1.679–4 applies to the transfer.

(b) *Interaction with sections 673 through 678*. The rules of this section apply without regard to whether the U.S. transferor retains any power or interest described in sections 673 through 677. If a U.S. transferor would be treated as the owner of a portion of a foreign trust pursuant to the rules of this section and another person would be treated as the owner of the same portion of the trust pursuant to section 678, then the U.S. transferor is treated as the owner and the other person is not treated as the owner.

(c) *Definitions*. The following definitions apply for purposes of this section and §§1.679–2 through 1.679–7:

(1) *U.S. transferor*. The term *U.S. transferor* means any U.S. person who makes a transfer (as defined in §1.679–3) of property to a foreign trust.

(2) *U.S. person*. The term *U.S. person* means a United States person as defined in section 7701(a)(30), a nonresident alien individual who elects under section 6013(g) to be treated as resident of the United States, and an individual who is a dual resident taxpayer within the meaning of §301.7701(b)–7(a) of this chapter.

(3) *Foreign trust*. Section 7701(a)(31)(B) defines the term *foreign trust*. See also §301.7701–7 of this chapter.

(4) *Property*. The term *property* means any property including cash.

(5) *Related person*. A person is a *related person* if, without regard to the transfer at issue, the person is—

(i) A grantor of any portion of the trust (within the meaning of §1.671–2(e)(1));

(ii) An owner of any portion of the trust under sections 671 through 679;

(iii) A beneficiary of the trust; or

(iv) A person who is related (within the meaning of section 643(i)(2)(B)) to any grantor, owner or beneficiary of the trust.

(6) *Obligation*. The term *obligation* means any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness, and, to the extent not previously described, any annuity contract.

(d) *Examples*. The following examples illustrate the rules of paragraph (a) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s father, who is a resident alien, *D* is *A*'s uncle, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

Example 1. Interaction with section 678. A creates and funds *FT*. *FT* may provide for the education of *B* by paying for books, tuition, room and board. In addition, *C* has the power to vest the trust corpus or income in himself within the meaning of section 678(a)(1). Under paragraph (b) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred to *FT* by *A* and *C* is not treated as the owner thereof.

Example 2. U.S. person treated as owner of a portion of FT. D creates and funds *FT* for the benefit of *B*. *D* retains a power described in section 676 and §1.672(f)–3(a)(1). *A* transfers property to *FT*. Under sections 676 and 672(f), *D* is treated as the owner of the portion of *FT* attributable to the property transferred by *D*. Under paragraph (a) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred by *A*.

§1.679–2 Trusts treated as having a U.S. beneficiary.

(a) *Existence of U.S. beneficiary*—(1) *In general*. The determination of whether a foreign trust has a U.S. beneficiary is made on an annual basis. A foreign trust is treated as having a U.S. beneficiary unless during the taxable year of the U.S. transferor—

(i) No part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, directly or indirectly, a U.S. person; and

(ii) If the trust is terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of, directly or indirectly, a U.S. person.

(2) *Benefit to a U.S. person*—(i) *In general*. For purposes of paragraph (a)(1) of this section, income or corpus may be paid or accumulated to or for the benefit of a U.S. person during a taxable year of the U.S. transferor if during that year, directly or indirectly, income may be distributed to, or accumulated for the benefit of, a U.S. person, or corpus may be distributed to, or held for the future benefit of, a U.S. person. This determination is made without regard to whether income or corpus is actually distributed to a U.S. person during that year, and without regard to whether a U.S. person's interest in the trust income or corpus is contingent on a future event.

(ii) *Certain unexpected beneficiaries*. Notwithstanding paragraph (a)(2)(i) of this section, for purposes of paragraph (a)(1) of this section, a person who is not named as a beneficiary and is not a member of a class of beneficiaries as defined under the trust instrument is not taken into consideration if the U.S. transferor demonstrates to the satisfaction of the Commissioner that the person's contingent interest in the trust is so remote as to be negligible. The preceding sentence does not apply with respect to persons to whom distributions could be made pursuant to a grant of discretion to the trustee or any other person. A class of beneficiaries generally does not include heirs who will benefit from the trust under the laws of intestate succession in the event that the named beneficiaries (or members of the named class) have all deceased (whether or not stated as a named class in the trust instrument).

(iii) *Examples*. The following examples illustrate the rules of paragraphs (a)(1) and (2) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

Example 1. Distribution of income to U.S. person. A transfers property to *FT*. The trust instrument provides that all trust income is to be distributed currently to *B*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary.

Example 2. Income accumulation for the benefit of a U.S. person. In 2001, *A* transfers property to *FT*. The trust instrument provides that from 2001 through 2010, the trustee of *FT* may distribute trust income to *C* or may accumulate the trust income. The trust instrument further provides that in 2011, the trust will terminate and the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust assets must be distributed to *C*. Because it is possible that income may be accumulated in each year, and that the accumulated income ultimately may be distributed to *B*, a U.S. person, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through 2011. This result applies even though no U.S. person may receive dis-

tributions from the trust during the tax years 2001 through 2010.

Example 3. Corpus held for the benefit of a U.S. person. The facts are the same as in *Example 2*, except that from 2001 through 2011, all trust income must be distributed to *C*. In 2011, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust corpus must be distributed to *C*. Because during each of *A*'s tax years from 2001 through 2011 trust corpus is held for possible future distribution to *B*, a U.S. person, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of those years. This result applies even though no U.S. person may receive distributions from the trust during the tax years 2001 through 2010.

Example 4. Distribution upon U.S. transferor's death. *A* transfers property to *FT*. The trust instrument provides that all trust income must be distributed currently to *C* and, upon *A*'s death, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*. Because *B* may receive a distribution of corpus upon the termination of *FT*, and *FT* could terminate in any year, *FT* is treated as having a U.S. beneficiary in the year of the transfer and in subsequent years.

Example 5. Distribution after U.S. transferor's death. The facts are the same as in *Example 4*, except the trust instrument provides that the trust will not terminate until the year following *A*'s death. Upon termination, the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. All trust assets are invested in the stock of *X*, a foreign corporation, and *X* makes no distributions to *FT*. Although no U.S. person may receive a distribution until the year after *A*'s death, and *FT* has no realized income during any year of its existence, during each year in which *A* is living corpus may be held for future distribution to *B*, a U.S. person. Thus, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through the year of *A*'s death.

Example 6. Constructive benefit to U.S. person. *A* transfers property to *FT*. The trust instrument provides that no income or corpus may be paid directly to a U.S. person. However, the trust instrument provides that trust corpus may be used to satisfy *B*'s legal obligations to a third party by making a payment directly to the third party. Under paragraphs (a)(1) and (2) of this section, *FT* is treated as having a U.S. beneficiary.

Example 7. U.S. person with negligible contingent interest. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *C*, and upon *C*'s death, all corpus is to be distributed to whomever of *C*'s three children is then living. All of *C*'s children are nonresident aliens. Under the laws of intestate succession that would apply to *FT*, if all of *C*'s children are deceased at the time of *C*'s death, the corpus would be distributed to *A*'s heirs. *A*'s living relatives at the time of the transfer consist solely of two brothers and two nieces, all of whom are nonresident aliens, and two first cousins, one of whom, *E*, is a U.S. citizen. Although it is possible under certain circumstances that *E* could receive a corpus distribution under the applicable laws of intestate succession, for each year the trust is in existence *A* is able to demonstrate to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that *E*'s contingent interest in *FT* is so remote as to be negligible. Provided that paragraph (a)(4) of this section does not require a different result, *FT* is not treated as having a U.S. beneficiary.

Example 8. U.S. person with non-negligible contingent interest. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. Under the laws of intestate succession that would apply to *FT*, *B* and *C* would share equally in the trust corpus if *D* is not living at the time of *A*'s death. *A* is unable to demonstrate to the satisfaction of the Commissioner that *B*'s contingent interest in the trust is so remote as to be negligible. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

Example 9. U.S. person as member of class of beneficiaries. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. If *D* is not then living, the corpus is to be distributed to *D*'s descendants. *D*'s grandson, *E*, is a resident alien. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

Example 10. Trustee's discretion in choosing beneficiaries. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of, any person who is pursuing the academic study of ancient Greek, in the trustee's discretion. Because it is possible that a U.S. person will receive distributions of income or corpus, or will have income accumulated for his benefit, *FT* is treated as having a U.S. beneficiary. This result applies even if, during a tax year, no distributions or accumulations are actually made to or for the benefit of a U.S. person. *A* may not invoke paragraph (a)(2)(ii) of this section because a U.S. person could benefit pursuant to a grant of discretion in the trust instrument.

Example 11. Appointment of remainder beneficiary. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute current income to C, or may accumulate income, and, upon termination of the trust, trust assets are to be distributed to *C*. However, the trust instrument further provides that *D*, *A*'s uncle, may appoint a different remainder beneficiary. Because it is possible that a U.S. person could be named as the remainder beneficiary, and because corpus could be held in each year for the future benefit of that U.S. person, *FT* is treated as having a U.S. beneficiary for each year.

Example 12. Trust not treated as having a U.S. beneficiary. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of *C*. Upon termination of the trust, all income and corpus must be distributed to *C*. Assume that paragraph (a)(4) of this section is not applicable under the facts and circumstances and that A establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Because no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, either directly or indirectly, a U.S. person, and if the trust is terminated, no part of the income or corpus of the trust could be paid to or for the benefit of, either directly or indirectly, a U.S. person, *FT* is not treated as having a U.S. beneficiary.

Example 13. U.S. beneficiary becomes non-U.S. person. In 2001, *A* transfers property to *FT*. The trust instrument provides that, as long as *B* remains a U.S. resident, no distributions of income or corpus may be made from the trust to *B*. The trust instrument further provides that if *B* becomes a nonresident alien, distributions of income (including previously accumulated income) and corpus may be made to him. If *B* remains a U.S. resident at the time of *FT*'s termination, all accumulated income and corpus is to be distributed to *C*. In 2007, *B* becomes a nonresident alien and remains so thereafter. Because income may be accumulated during the years 2001 through 2007 for the benefit of a person who is a U.S. person during those years, *FT* is treated as having a U.S. beneficiary under paragraph (a)(1) of this section during each of those years. This result applies even though *B* cannot receive distributions from *FT* during the years he is a resident alien and even though *B* might remain a resident alien who is not entitled to any distribution from *FT*. Provided that paragraph (a)(4) of this section does not require a different result and that *A* establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no other U.S. persons are reasonably expected to benefit from the trust, *FT* is not treated as having a U.S. beneficiary under paragraph (a)(1) of this section during tax years after 2007.

(3) *Changes in beneficiary's status*—(i) *In general*. For purposes of paragraph (a)(1) of this section, the possibility that a person that is not a U.S. person could become a U.S. person will not cause that person to be treated as a U.S. person for purposes of paragraph (a)(1) of this section until the tax year of the U.S. transferor in which that individual actually becomes a U.S. person. However, if a person who is not a U.S. person becomes a U.S. person for the first time more than 5 years after the date of a transfer to the foreign trust by a U.S. transferor, that person is not treated as a U.S. person for purposes of applying paragraph (a)(1) of this section with respect to that transfer.

(ii) *Examples*. The following examples illustrate the rules of paragraph (a)(3) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

Example 1. Non-U.S. beneficiary becomes U.S. person. In 2001, *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *C* and that, upon the termination of *FT*, all corpus is to be distributed to *C*. Assume that paragraph (a)(4) of this section is not applicable

under the facts and circumstances and that *A* establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Under paragraph (a)(3)(i) of this section, *FT* is not treated as having a U.S. beneficiary during the tax years of *A* in which *C* remains a nonresident alien. If *C* first becomes a resident alien in 2004, *FT* is treated as having a U.S. beneficiary commencing in that year under paragraph (a)(3) of this section. See paragraph (c) of this section regarding the treatment of *A* upon *FT*'s acquisition of a U.S. beneficiary.

Example 2. Non-U.S. beneficiary becomes U.S. person more than 5 years after transfer. The facts are the same as in *Example 1*, except *C* first becomes a resident alien in 2007. *FT* is treated as not having a U.S. beneficiary under paragraph (a)(3)(i) of this section with respect to the property transfer by *A*. However, if *C* had previously been a U.S. person during any prior period, the 5-year exception in paragraph (a)(3)(i) of this section would not apply in 2007 because it would not have been the first time *C* became a U.S. person.

(4) *General rules*—(i) *Records and documents*. Even if, based on the terms of the trust instrument, a foreign trust is not treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the trust may nevertheless be treated as having a U.S. beneficiary pursuant to paragraph (a)(1) of this section based on the following—

(A) All written and oral agreements and understandings relating to the trust;

(B) Memoranda or letters of wishes;

(C) All records that relate to the actual distribution of income and corpus; and

(D) All other documents that relate to the trust, whether or not of any purported legal effect.

(ii) *Additional factors*. For purposes of determining whether a foreign trust is treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the following additional factors are taken into account—

(A) If the terms of the trust instrument allow the trust to be amended to benefit a U.S. person, all potential benefits that could be provided to a U.S. person pursuant to an amendment must be taken into account;

(B) If the terms of the trust instrument do not allow the trust to be amended to benefit a U.S. person, but the law applicable to a foreign trust may require payments or accumulations of income or corpus to or for the benefit of a U.S. person (by judicial reformation or otherwise), all potential benefits that could be provided to a U.S. person pursuant to the law must be taken into account, unless the U.S. transferor demonstrates to the satisfaction of the Commissioner that the law is not reasonably expected to be applied or invoked under the facts and circumstances; and

(C) If the parties to the trust ignore the terms of the trust instrument, or if it is reasonably expected that they will do so, all benefits that have been, or are reasonably expected to be, provided to a U.S. person must be taken into account.

(iii) *Examples*. The following examples illustrate the rules of paragraph (a)(4) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

Example 1. Amendment pursuant to local law. *A* creates and funds *FT* for the benefit of *C*. The terms of *FT* (which, according to the trust instrument, cannot be amended) provide that no part of the income or corpus of *FT* may be paid or accumulated during the taxable year to or for the benefit of any U.S. person, either during the existence of *FT* or at the time of its termination. However, pursuant to the applicable foreign law, *FT* can be amended to provide for additional beneficiaries, and there is an oral understanding between *A* and the trustee that *B* can be added as a beneficiary. Under paragraphs (a)(1) and (a)(4)(ii)(B) of this section, *FT* is treated as having a U.S. beneficiary.

Example 2. Actions in violation of the terms of the trust. *A* transfers property to *FT*. The trust instrument provides that no U.S. person can receive income or corpus from *FT* during the term of the trust or at the termination of *FT*. Notwithstanding the terms of the trust instrument, a letter of wishes directs the trustee of *FT* to provide for the educational needs of *B*, who is about to begin college. The letter of wishes contains a disclaimer to the effect that its contents are only suggestions and recommendations and that the trustee is at all times bound by the terms of the trust as set forth in the trust instrument. Under paragraphs (a)(1) and (a)(4)(ii)(C) of this section, *FT* is treated as having a U.S. beneficiary.

(b) *Indirect U.S. beneficiaries*—(1) *Certain foreign entities*. For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of—

(i) A controlled foreign corporation, as defined in section 957(a);

(ii) A foreign partnership, if a U.S. person is a partner of such partnership; or

(iii) A foreign trust or estate, if such trust or estate has a U.S. beneficiary (within the meaning of paragraph (a)(1) of this section).

(2) *Other indirect beneficiaries*. For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of a U.S. person through an intermediary, such as an agent or nominee, or by any other means where a U.S. person may obtain an actual or constructive benefit.

(3) *Examples*. The following examples illustrate the rules of this paragraph (b). Unless otherwise noted, *A* is a resident alien. *B* is *A*'s son and is a resident alien. *FT* is a foreign trust. The examples are as follows:

Example 1. Trust benefitting foreign corporation. *A* transfers property to *FT*. The beneficiary of *FT* is *FC*, a foreign corporation. *FC* has outstanding solely 100 shares of common stock. *B* owns 49 shares of the *FC* stock and *FC2*, also a foreign corporation, owns the remaining 51 shares. *FC2* has outstanding solely 100 shares of common stock. *B* owns 49 shares of *FC2* and nonresident alien individuals own the remaining 51 *FC2* shares. *FC* is a controlled foreign corporation (as defined in section 957(a), after the application of section 958(a)(2)). Under paragraphs (a)(1) and (b)(1)(i) of this section, *FT* is treated as having a U.S. beneficiary.

Example 2. Trust benefitting another trust. *A* transfers property to *FT*. The terms of *FT* permit current distributions of income to *B*. *A* transfers property to another foreign trust, *FT2*. The terms of *FT2* provide that no U.S. person can benefit either as to income or corpus, but permit current distributions of income to *FT*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary and, under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT2* is treated as having a U.S. beneficiary.

Example 3. Trust benefitting another trust after transferor's death. *A* transfers property to *FT*. The terms of *FT* require that all income from *FT* be accumulated during *A*'s lifetime. In the year following *A*'s death, a share of *FT* is to be distributed to *FT2*, another foreign trust, for the benefit of *B*. Under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT* is treated as having a U.S. beneficiary beginning with the year of *A*'s transfer of property to *FT*.

Example 4. Indirect benefit through use of debit card. *A* transfers property to *FT*. The trust instrument provides that no U.S. person can benefit either as to income or corpus. However, *FT* maintains an account with *FB*, a foreign bank, and *FB* issues a debit card to *B* against the account maintained by *FT* and *B* is allowed to make withdrawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

Example 5. Other indirect benefit. *A* transfers property to *FT*. *FT* is administered by *FTC*, a foreign trust company. *FTC* forms *IBC*, an international business corporation formed under the laws of a foreign jurisdiction. *IBC* is the beneficiary of *FT*. *IBC* maintains an account with *FB*, a foreign bank. *FB* issues a debit card to *B* against the account maintained by *IBC* and *B* is allowed to make with-

drawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

(c) *Treatment of U.S. transferor upon foreign trust's acquisition or loss of U.S. beneficiary—(1) Trusts acquiring a U.S. beneficiary*. If a foreign trust to which a U.S. transferor has transferred property is not treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) for any taxable year of the U.S. transferor, but the trust is treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) in any subsequent taxable year, the U.S. transferor is treated as having additional income in the first such taxable year of the U.S. transferor in which the trust is treated as having a U.S. beneficiary. The amount of the additional income is equal to the trust's undistributed net income, as defined in section 665(a), at the end of the U.S. transferor's immediately preceding taxable year and is subject to the rules of section 668, providing for an interest charge on accumulation distributions from foreign trusts.

(2) *Trusts ceasing to have a U.S. beneficiary*. If, for any taxable year of a U.S. transferor, a foreign trust that has received a transfer of property from the U.S. transferor ceases to be treated as having a U.S. beneficiary, the U.S. transferor ceases to be treated as the owner of the portion of the trust attributable to the transfer beginning in the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary (unless the U.S. transferor is treated as an owner thereof pursuant to sections 673 through 677). The U.S. transferor is treated as making a transfer of property to the foreign trust on the first day of the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary. The amount of the property deemed to be transferred to the trust is the portion of the trust attributable to the prior transfer to which paragraph (a)(1) of this section applied. For rules regarding the recognition of gain on transfers to foreign trusts, see section 684.

(3) *Examples*. The rules of this paragraph (c) are illustrated by the following examples. *A* is a resident alien, *B* is *A*'s son, and *FT* is a foreign trust. The examples are as follows:

Example 1. Trust acquiring U.S. beneficiary. (i) In 2001, *A* transfers stock with a fair market value of $100,000 to *FT*. The stock has an adjusted basis of $50,000 at the time of the transfer. The trust instrument provides that income may be paid currently to, or accumulated for the benefit of, *B* and that, upon the termination of the trust, all income and corpus is to be distributed to *B*. At the time of the transfer, *B* is a nonresident alien. *A* is not treated as the owner of any portion of *FT* under sections 673 through 677. *FT* accumulates a total of $30,000 of income during the taxable years 2001 through 2003. In 2004, *B* moves to the United States and becomes a resident alien. Assume paragraph (a)(4) of this section is not applicable under the facts and circumstances.

(ii) Under paragraph (c)(1) of this section, *A* is treated as receiving an accumulation distribution in the amount of $30,000 in 2004 and immediately transferring that amount back to the trust. The accumulation distribution is subject to the rules of section 668, providing for an interest charge on accumulation distributions.

(iii) Under paragraphs (a)(1) and (3) of this section, beginning in 2005, *A* is treated as the owner of the portion of *FT* attributable to the stock transferred by *A* to *FT* in 2001 (which includes the portion attributable to the accumulated income deemed to be retransferred in 2004).

Example 2. Trust ceasing to have U.S. beneficiary. (i) The facts are the same as in *Example 1*. In 2008, *B* becomes a nonresident alien. On the date *B* becomes a nonresident alien, the stock transferred by *A* to *FT* in 2001 has a fair market value of $125,000 and an adjusted basis of $50,000.

(ii) Under paragraph (c)(2) of this section, beginning in 2009, *FT* is not treated as having a U.S. beneficiary, and *A* is not treated as the owner of the portion of the trust attributable to the prior transfer of stock. For rules regarding the recognition of gain on the termination of ownership status, see section 684.

§1.679–3 Transfers.

(a) *In general*. A transfer means a direct, indirect, or constructive transfer.

(b) *Transfers by certain trusts*—(1) *In general*. If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Example*. The following example illustrates this paragraph (b):

Example. In 2001, *A*, a U.S. citizen, creates and funds *DT*, a domestic trust. *A* has the power to revest absolutely in himself the title to the property in *DT* and is treated as the owner of *DT* pursuant to section 676. In 2004, *DT* transfers property to *FT*, a foreign trust. *A* is treated as having transferred the property to *FT* in 2004 for purposes of this section.

(c) *Indirect transfers*—(1) *Principal purpose of tax avoidance*. A transfer to a foreign trust by any person (intermediary) to whom a U.S. person transfers property is treated as an indirect transfer by a U.S. person to the foreign trust if such transfer is made pursuant to a plan one of the principal purposes of which is the avoidance of United States tax.

(2) *Principal purpose of tax avoidance deemed to exist*. For purposes of paragraph (c)(1) of this section, a transfer is deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of United States tax if—

(i) The U.S. person is related (within the meaning of paragraph (c)(4) of this section) to a beneficiary of the foreign trust, or has another relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the U.S. transferor would make a transfer to the foreign trust; and

(ii) The U.S. person cannot demonstrate to the satisfaction of the Commissioner that—

(A) The intermediary has a relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the intermediary would make a transfer to the foreign trust;

(B) The intermediary acted independently of the U.S. person;

(C) The intermediary is not an agent of the U.S. person under generally applicable United States agency principles; and

(D) The intermediary timely complied with the reporting requirements of section 6048, if applicable.

(3) *Effect of disregarding intermediary*—(i) *In general*. Except as provided in paragraph (c)(3)(ii) of this section, if a transfer is treated as an indirect transfer pursuant to paragraph (c)(1) of this section, then the intermediary is treated as an agent of the U.S. person, and the property is treated as transferred to the foreign trust by the U.S. person in the year the property is transferred, or made available, by the intermediary to the foreign trust. The fair market value of the property transferred is determined as of the date of the transfer by the intermediary to the foreign trust.

(ii) *Special rule*. If the Commissioner determines, or if the taxpayer can demonstrate to the satisfaction of the Commissioner, that the intermediary is an agent of the foreign trust under generally applicable United States agency principles, the property will be treated as transferred to the foreign trust in the year the U.S. person transfers the property to the interme-

diary. The fair market value of the property transferred will be determined as of the date of the transfer by the U.S. person to the intermediary.

(iii) *Effect on intermediary*. If a transfer of property is treated as an indirect transfer under paragraph (c)(1) of this section, the intermediary is not treated as having transferred the property to the foreign trust.

(4) *Related parties*. For purposes of this paragraph (c), a U.S. transferor is treated as related to a U.S. beneficiary of a foreign trust if the U.S. transferor and the beneficiary are related for purposes of section 643(i)(2)(B), with the following modifications—

(i) For purposes of applying section 267 (other than section 267(f)) and section 707(b)(1), "at least 10 percent" is used instead of "more than 50 percent" each place it appears; and

(ii) The principles of section 267(b)(10), using "at least 10 percent" instead of "more than 50 percent," apply to determine whether two corporations are related.

(5) *Examples*. The rules of this paragraph (c) are illustrated by the following examples:

Example 1. Principal purpose of tax avoidance. A, a U.S. citizen, creates and funds *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. In 2004, *A* decides to transfer an additional 1000X to the foreign trust. Pursuant to a plan with a principal purpose of avoiding the application of section 679, A transfers 1000X to *I*, a foreign person. *I* subsequently transfers 1000X to *FT*. Under paragraph (c)(1) of this section, *A* is treated as having made a transfer of 1000X to *FT*.

Example 2. U.S. person unable to demonstrate that intermediary acted independently. A, a U.S. citizen, creates and funds *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. On July 1, 2004, *A* transfers XYZ stock to *D*, *A*'s uncle, who is a nonresident alien. *D* immediately sells the XYZ stock and uses the proceeds to purchase ABC stock. On January 1, 2007, *D* transfers the ABC stock to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that *D* acted independently of *A* in making the transfer to FT. Under paragraph (c)(1) of this section, *A* is treated as having transferred the ABC stock to *FT*. Under paragraph (c)(3) of this section, *D* is treated as an agent of *A*, and the transfer is deemed to have been made on January 1, 2007.

Example 3. Indirect loan to foreign trust. A, a U.S. citizen, previously created and funded *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. On July 1, 2004, *A* deposits 500X with *FB*, a foreign bank. On January 1, 2005, *FB* loans 450X to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that *FB* has a relationship with *FT* that establishes a reasonable basis for concluding that *FB* would make a loan to *FT* or that *FB* acted independently of *A* in making the loan. Under paragraph (c)(1) of this section, *A* is deemed to have transferred 450X directly to *FT* on January 1, 2005. Under paragraph (c)(3) of this section, *FB* is treated as an agent of *A*. For possible exceptions with respect to qualified obligations of the trust, and the treatment of principal repayments with respect to obligations of the trust that are not qualified obligations, see §1.679–4.

Example 4. Loan to foreign trust prior to deposit of funds in foreign bank. The facts are the same as in *Example 3*, except that *A* makes the 500X deposit with *FB* on January 2, 2005, the day after *FB* makes the loan to *FT*. The result is the same as in *Example 3*.

(d) *Constructive transfers*—(1) *In general*. For purposes of paragraph (a) of this section, a constructive transfer includes any assumption or satisfaction of a foreign trust's obligation to a third party.

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

Example 1. Payment of debt of foreign trust. FT owes 1000X to *Y*, an unrelated foreign corporation, for the performance of services by *Y* for *FT*. In satisfaction of *FT*'s liability to *Y*, *A* transfers to *Y* property with a fair market value of 1000X. Under paragraph (d)(1) of this section, *A* is treated as having made a constructive transfer of the property to *FT*.

Example 2. Assumption of liability of foreign trust. FT owes 1000X to *Y*, an unrelated foreign corporation, for the performance of services by *Y* for *FT*. *A* assumes *FT*'s liability to pay *Y*. Under paragraph (d)(1) of this section, *A* is treated as having made a constructive transfer of property with a fair market value of 1000X to *FT*.

(e) *Guarantee of trust obligations*—(1) *In general*. If a foreign trust borrows money or other property from any person who is not a related person (within the meaning of §1.679–1(c)(5)) with respect to the trust (lender) and a U.S. person (U.S. guarantor) that is a related person with respect to the trust guarantees (within the meaning of paragraph (e)(4) of this section) the foreign trust's obligation, the U.S. guarantor is treated for purposes of this section as a U.S. transferor that has made a transfer to the trust on the date of the guarantee in an amount determined under paragraph (e)(2) of this section. To the extent this paragraph causes the U.S. guarantor to be treated as having made a transfer to the trust, a lender that is a U.S. person shall not be treated as having transferred that amount to the foreign trust.

(2) *Amount transferred*. The amount deemed transferred by a U.S. guarantor described in paragraph (e)(1) of this section is the guaranteed portion of the adjusted issue price of the obligation (within the meaning of §1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273–1(c)).

(3) *Principal repayments*. If a U.S. person is treated under this paragraph (e) as having made a transfer by reason of the guarantee of an obligation, payments of principal to the lender by the foreign trust with respect to the obligation are taken into account on and after the date of the payment in determining the portion of the trust attributable to the property deemed transferred by the U.S. guarantor.

(4) *Guarantee*. For purposes of this section, the term guarantee—

(i) Includes any arrangement under which a person, directly or indirectly, assures, on a conditional or unconditional basis, the payment of another's obligation;

(ii) Encompasses any form of credit support, and includes a commitment to make a capital contribution to the debtor or otherwise maintain its financial viability; and

(iii) Includes an arrangement reflected in a comfort letter, regardless of whether the arrangement gives rise to a legally enforceable obligation. If an arrangement is contingent upon the occurrence of an event, in determining whether the arrangement is a guarantee, it is assumed that the event has occurred.

(5) *Examples*. The rules of this paragraph (e) are illustrated by the following examples. In all of the examples, *A* is a U.S. resident and *FT* is a foreign trust. The examples are as follows:

Example 1. Foreign lender. X, a foreign corporation, loans 1000X of cash to *FT* in exchange for *FT*'s obligation to repay the loan. *A* guarantees the repayment of 600X of *FT*'s obligation. Under paragraph (e)(2) of this section, *A* is treated as having transferred 600X to *FT*.

Example 2. Unrelated U.S. lender. The facts are the same as in *Example 1*, except *X* is a U.S. person that is not a related person within the meaning of §1.679–1(c)(5). The result is the same as in *Example 1*.

(f) *Transfers to entities owned by a foreign trust*—(1) *General rule*. If a U.S. person is a related person (as defined in §1.679–1(c)(5)) with respect to a foreign trust, any transfer of property by the U.S. person to an entity in which the foreign trust holds an ownership interest is treated as a transfer of such property by the U.S.

person to the foreign trust followed by a transfer of the property from the foreign trust to the entity owned by the foreign trust, unless the U.S. person demonstrates to the satisfaction of the Commissioner that the transfer to the entity is properly attributable to the U.S. person's ownership interest in the entity.

(2) *Examples*. The rules of this paragraph (f) are illustrated by the following examples. In all of the examples, *A* is a U.S. citizen, *FT* is a foreign 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*.

§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 that 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 preexisting 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.

§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 equal to the portion of the trust attributable to the property transferred by the individual in the original transfer.

(b) *Special rules*—(1) *Change in grantor trust status*. For purposes of paragraph (a) of this section, if a nonresident alien individual who is treated as owning any portion of a trust under the provisions of subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, subsequently ceases to be so treated, the individual is treated as having made the original transfer to the foreign trust immediately before the trust ceases to be treated as owned by the individual.

(2) *Treatment of undistributed income*. For purposes of paragraph (a) of this section, the property deemed transferred to the foreign trust on the residency starting date includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred. Undistributed net income for periods before the individual's residency starting date is taken into account only for purposes of determining the amount of the property deemed transferred.

(c) *Examples*. The rules of this section are illustrated by the following examples:

Example 1. Nonresident alien becomes resident alien. On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. On January 1, 2006, *A* becomes a resident of the United States within the meaning of section 7701(b)(1)(A) and has a residency starting date of January 1, 2006, within the meaning of section 7701(b)(2)(A). Under paragraph (a) of this section, *A* is treated as a U.S. transferor and is deemed to transfer the property to *FT* on January 1, 2006. Under paragraph (b)(2) of this section, the property deemed transferred to *FT* on January 1, 2006, includes the undistributed net income of the trust, as defined in section 665(a), attributable to the property originally transferred.

Example 2. Nonresident alien loses power to revest property. On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. *A* has the power to revest absolutely in himself the title to such property transferred and is treated as the owner of the trust pursuant to sections 676 and 672(f). On January 1, 2008, the terms of *FT* are amended to remove *A*'s power to revest in himself title to the property transferred, and *A* ceases to be treated as the owner of *FT*. On January 1, 2010, *A* becomes a resident of the United States. Under paragraph (b)(1) of this section, for purposes of paragraph (a) of this section *A* is treated as having originally transferred the property to *FT* on January 1, 2008. Because this date is within five years of *A*'s residency starting date, *A* is deemed to have made a transfer to the foreign trust on January 1, 2010, his residency starting date. Under paragraph (b)(2) of this section, the property deemed transferred to the foreign trust on January 1, 2010, includes the undistributed net income of the trust, as defined in section 665(a), attributable to the property deemed transferred.

§1.679–6 Outbound migrations of domestic trusts.

(a) *In general*. Subject to the provisions of paragraph (b) of this section, if an individual who is a U.S. person transfers property to a trust that is not a foreign trust, and such trust becomes a foreign trust while the U.S. person is alive, the U.S. individual is treated as a U.S. transferor and is deemed to transfer the property to a foreign trust on the date the domestic trust becomes a foreign trust.

(b) *Amount deemed transferred*. For purposes of paragraph (a) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property previously transferred. Undistributed net income for periods prior to the migration is taken into account only for purposes of determining the portion of the trust that is attributable to the property transferred by the U.S. person.

(c) *Example*. The following example illustrates the rules of this section. For purposes of the example, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, and *DT* is a domestic trust. The example is as follows:

Example. Outbound migration of domestic trust. On January 1, 2002, *A* transfers property to *DT*, for the benefit of *B*. On January 1, 2003, *DT* acquires a foreign trustee who has the power to determine whether and when distributions will be made to *B*. Under section 7701(a)(30)(E) and §301.7701–7(d)(ii)(A) of this chapter, *DT* becomes a foreign trust on January 1, 2003. Under paragraph (a) of this section, *A* is treated as transferring property to a foreign trust on January 1, 2003. Under paragraph (b) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred.

§1.679–7 Effective dates.

(a) *In general*. Except as provided in paragraph (b) of this section, the rules of §§1.679–1, 1.679–2, 1.679–3, and 1.679–4 apply with respect to transfers after August 7, 2000.

(b) *Special rules*. (1) The rules of §1.679–4(c) and (d) apply to an obligation issued after February 6, 1995, whether or not in accordance with a pre-existing arrangement or understanding. For purposes of the rules of §1.679–4(c) and (d), if an obligation issued on or before February 6, 1995, is modified after that date, and the modification is a significant modification within the meaning of §1.1001–3, the obligation is treated as if it were issued on the date of the modification. However, the penalty provided in section 6677 applies only to a failure to report transfers in exchange for obligations issued after August 20, 1996.

(2) The rules of §1.679–5 apply to persons whose residency starting date is after August 7, 2000.

(3) The rules of §1.679–6 apply to trusts that become foreign trusts after August 7, 2000.

Par. 3. In §1.958–1, the first sentence of paragraph (b) is revised to read as follows:

§1.958–1 Direct and indirect ownership of stock.

* * * * *

(b) * * * For purposes of paragraph (a)(2) of this section, stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, foreign trust (within the meaning of section 7701(a)(31)) described in sections 671 through 679, or other foreign trust or foreign estate (within the meaning of section 7701(a)(31)) shall be considered as being owned proportionately by its shareholders, partners, grantors or other persons treated as owners under sections 671 through 679 of any portion of the trust that includes the stock, or beneficiaries, respectively. * * *

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§1.958–2 [Amended]

Par. 4. In §1.958–2, paragraph (c)(1)(ii)(*b*) is amended by removing the language "678" and adding "679" in its place.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 9, 2001.

Mark Weinberger,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 19, 2001, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2001, 66 F.R. 37886)

Section 684.—Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates

26 CFR 1.684–1: Recognition of gain on transfers to certain foreign trusts and estates.

T.D. 8956

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 684 of the Internal Revenue Code relating to recog-

nition of gain on certain transfers to certain foreign trusts and estates. The regulations affect United States persons who transfer property to foreign trusts and estates.

DATES: *Effective Date*: These regulations are effective July 20, 2001.

Applicability Date: These regulations are applicable to transfers of property to foreign trusts and foreign estates after August 7, 2000.

FOR FURTHER INFORMATION CONTACT: Karen A. Rennie-Quarrie, (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations relating to the Income Tax Regulations (CFR part 1) under section 684 of the Internal Revenue Code (Code). On August 7, 2000, Treasury and the IRS published a notice of proposed rulemaking (REG–108522–00, 2000–34 I.R.B. 187) in the **Federal Register** (65 FR 48198) under section 684 of the Code relating to gain recognition on transfers of property by U.S. persons to foreign trusts and estates. Comments responding to the notice of proposed rulemaking were received and a public hearing was held on November 8, 2000. After consideration of all comments, the proposed regulations are adopted as final regulations as revised by this Treasury decision.

Explanation of Provisions

I. *Comments and Changes to §1.684–1: Recognition of Gain on Transfers to Certain Foreign Trusts and Estates*

Under the proposed regulations, a U.S. person who transfers property to a foreign trust or estate generally must recognize gain immediately even if deferral might otherwise be permitted under another provision of the Code.

One commenter questioned the authority for the conclusion in §1.684–1(d) *Example 4* that a U.S. person must recognize gain immediately upon the transfer of appreciated property to a foreign trust in exchange for a private annuity. The general rule in section 684(a) provides, in part, that the transfer to the foreign trust is treated as a sale or exchange for an amount equal to the fair market value of the property transferred and the transferor must recognize the gain in the property, except as provided in regulations. The language of section 684(a) does not provide for any deferral of this gain. Moreover, the legislative history of former section 1491 (the predecessor of section 684 regarding transfers of property by U.S. persons to foreign trusts) makes it clear that Congress did not look favorably upon deferral in the context of transfers to foreign trusts in exchange for private annuities: "The committee believes that any policy in favor of permitting deferral of tax in private annuity transactions should not apply to a private annuity transaction with a foreign trust." S. Rep. No. 94–938, at 217, n.5 (1976). Therefore, Treasury and the IRS do not believe it would be appropriate to adopt regulations that would permit deferral in such a case. The final regulations retain *Example 4* without modification.

II. *Comments and Changes to §1.684–2: Transfers*

The proposed regulations define the term *transfer* broadly to mean any direct, indirect, or constructive transfer. Section 1.684–2(e) of the proposed regulations provides that if any portion of a foreign trust is treated as owned by a U.S. person and such portion ceases to be treated as owned by such U.S. person, the U.S. person is treated as having transferred the assets of such portion to a foreign trust immediately before the trust is no longer treated as owned by the U.S. person. Section 1.684–2(e)(2) *Example 2* illustrates this rule in the case of the death of the grantor.

One commenter questioned the authority for the position that death is a transfer to which section 684 applies. Section 684(a) expressly applies to "*any* transfer of property by a United States person to a foreign estate or trust" (emphasis added). Section 679 also generally applies to transfers of property by U.S. persons to foreign trusts. In the case of section 679, however, section 679(a)(2)(A) specifically excepts transfers by reason of death from the application of the general rule of section 679. This exception implies that Congress believed that, unless otherwise excepted, a transfer by reason of death would be a transfer to which section 679 applied. Because Congress provided no exception in section 684 for transfers by reason of death, it follows that section 684 applies to such transfers. Additional support for this conclusion is found in the information reporting rules in section 6048(a)(3)(A)(ii), which provides that a "reportable event" includes "the transfer of any money or property (directly or indirectly) to a foreign trust by a United States person, *including a transfer by reason of death*" (emphasis added). Although section 684 generally applies to transfers by reason of death, §1.684–3(c) provides an exception to the general rule of gain recognition in the case of certain transfers at death.

One commenter requested guidance concerning a transfer of property by a domestic trust (that is not treated as owned by another person) to a foreign trust as a result of the testamentary exercise of a limited power of appointment with respect to the domestic trust. Treasury and the IRS believe that, under general principles regarding limited powers of appointment, the domestic trust, and not the holder of the limited power of appointment, is the transferor of the property. Accordingly, the domestic trust must recognize gain under the general rule of §1.684–1(a) unless an exception applies. The final regulations do not include any special rules for such transfers.

One commenter asked about the interaction of §1.684–2(d) and §1.684–2(e) in the context of an actual transfer of property from a foreign trust that is treated as owned by a U.S. person to either a foreign charitable organization or a U.S. charity. Under §1.684–2(d) of the proposed regulations, if any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner. Under §1.684–2(e) of the proposed regulations, if a portion of a foreign trust that is treated as owned by a U.S. person ceases to be treated as owned by the U.S. person, the U.S. person is treated as having transferred the assets of that portion of the trust to a foreign trust immediately before such portion is no longer treated as owned by the U.S. person.

The commenter noted that §1.684–2(e) of the proposed regulation could be read to apply in situations where a portion of a

foreign trust ceases to be treated as owned by a U.S. person because of an actual transfer of property from the trust. The final regulations clarify that §1.684–2(e) does not apply (and that §1.684–2(d) may apply) when any portion of a trust ceases to be owned by a U.S. person by reason of an actual transfer of property from the trust. As a result, the general rule of gain recognition under §1.684–1(a) would not apply to an actual transfer by a foreign trust that is treated as owned by a U.S. person to a foreign charitable trust that meets the requirements of §1.684–3(b), or to a U.S. charity, even if the transfer causes the portion of the trust to cease to be owned by the U.S. person.

III. *Comments and Changes to §1.684–3: Exceptions to the General Rule of Gain Recognition*

Section 1.684–3(a) of the proposed regulations provides that a U.S. person who transfers property to a foreign trust is not required to recognize gain on the transfer to the extent that any person is treated as the owner of the trust under section 671. One commenter questioned whether the term *any person* includes foreign persons. Although not specifically addressed in the final regulations, it is understood that the term *any person* includes foreign as well as U.S. persons.

Section 1.684–3(b) of the proposed regulations provides an exception for transfers to a foreign trust that has already received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3), provided that the letter has been neither revoked nor modified. Commenters questioned the requirement that a foreign trust obtain a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). They assert that the requirement may interfere with a U.S. person's ability to make contributions to a foreign charitable entity that may not be familiar with U.S. tax laws and may not have any reason to obtain a determination letter from the IRS. They suggest that the final regulations require only that the U.S. transferor disclose to the IRS, at such time and in such manner as the IRS may provide, that the transfer has been made and that the U.S. transferor believes the transferee is an organization described in section 501(c)(3).

In response to commenters' concerns, the final regulations eliminate the requirement that the foreign trust receive a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). The final regulations provide, instead, that the general rule of gain recognition does not apply to any transfer of property to a foreign trust that is described in section 501(c)(3) (without regard to the requirements of section 508(a)). However, taxpayers should be aware that, under Notice 97–34 (1997–1 C.B. 422), the U.S. transferor has a reporting obligation on Form 3520 with respect to such a transfer, unless the foreign trust has received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). Moreover, if the IRS subsequently determines that the foreign trust is not described in section 501(c)(3), the exception will not apply and the U.S. transferor will be required to recognize gain as of the time of the original transfer, and may be subject to interest and penalties, if applicable.

Section 1.684–3(c) of the proposed regulations provides an exception for transfers of property by reason of the death of the U.S. transferor if both of the following requirements are satisfied: (1) the property is included in the U.S. transferor's gross estate for Federal estate tax purposes, and (2) the basis of the property in the hands of the foreign trust is determined under section 1014(a). One commenter questioned whether section 684 would apply in the case of an individual who is a U.S. person for income tax purposes, but a non-domiciliary for estate tax purposes, with the result that the property of the individual would be entitled to a step-up in basis, but would not be included in the individual's gross estate. The final regulations eliminate the requirement that the property be included in the U.S. transferor's gross estate and allow the exception to apply as long as the basis of the property in the hands of the foreign trust is determined under section 1014(a).

Another commenter requested that the final regulations confirm that section 1032 applies to provide for nonrecognition of gain on issuer stock transferred to a foreign trust. The commenter noted that under former section 1491, no excise tax was imposed on a transfer of stock by a foreign corporation to a foreign trust if the corporation was not required to recognize gain on the transfer under section 1032. See Notice 97–18 (1997–1 C.B. 389, Sec. II.A.1). In response to this comment, §1.684–3(e) of the final regulations provides a new exception for transfers of stock (including treasury stock) by a domestic corporation to a foreign trust if the domestic corporation is not required to recognize gain on the transfer under section 1032.

Commenters also suggested that contributions by U.S. persons to foreign compensatory trusts described in sections 402(b), 404(a)(4), or 404A should be exempt from gain recognition under section 684. Treasury and the IRS have considered the proposed exception but do not believe it is consistent with the intended purpose of section 684. Accordingly, the final regulations do not include an exception for transfers to foreign compensatory trusts. However, the exception for transfers of stock to which section 1032 would apply may be available in appropriate cases for transfers of stock of a domestic parent company to a foreign compensatory trust set up by a foreign subsidiary.

Another commenter requested an exception for transfers of life insurance contracts to foreign trusts. The commenter noted that the proceeds of life insurance contracts do not generally give rise to any taxable gain if held by a U.S. individual or trust. Congress has recognized that life insurance contracts might be used to effectuate inappropriate outbound transfers of property. As part of the repeal of section 1491 in 1997, Congress enacted section 1035(c), which provides regulatory authority to deny the nonrecognition treatment given to exchanges of life insurance contracts under section 1035(a) where the exchange has the effect of transferring property to any person other than a U.S. person. Public Law 105–34, §1131(b)[(c)](1). Because of the potential for abuse and the lack of a compelling reason for creating an exception for offshore transfers of life insurance contracts, Treasury and the IRS have concluded that such an exception is not warranted.

IV. *Comments and Changes to §1.684–4: Outbound Migration of Domestic Trusts*

Section 1.684–4 of the proposed regulation provides that if a U.S. person trans-

fers property to a domestic trust and, for any reason, the domestic trust becomes a foreign trust, the domestic trust will be deemed to have transferred all of its assets to a foreign trust and the domestic trust must immediately recognize gain. The proposed regulations do, however, incorporate the relief for inadvertent migrations that is set forth in §301.7701–7(d)(2).

One commenter suggested that the final regulations should extend the inadvertent migration rules of §301.7701–7(d)(2) to apply to §301.7701–7(f), which deals with the election by certain trusts to remain domestic trusts. Under §301.7701–7(d)(2), in the event of an inadvertent change in any person that has the power to make a substantial decision of the trust that would cause the domestic or foreign residency of the trust to change (*e.g.*, an inadvertent change from a U.S. trustee to a foreign trustee by reason of the U.S. trustee's death), the trust is allowed 12 months to make necessary changes to avoid a change in the trust's residency (*e.g.*, the replacement of the foreign successor trustee with a U.S. successor trustee). The commenter suggests that a trust with an election in force under §301.7701–7(d)(2) should be allowed a similar amount of time to make necessary changes if a U.S. trustee is inadvertently replaced by a foreign trustee.

The final regulations do not include such a rule. Under §301.7701–7(f), a trust generally can elect to remain a domestic trust if it was in existence on August 20, 1996, and it was treated as a domestic trust on August 19, 1996. Section 301.7701–7(f)(4)(ii) provides that such an election terminates if subsequent changes are made to the trust that result in the trust no longer having any reasonable basis for being treated as a domestic trust under section 7701(a)(30) prior to its amendment by the Small Business Job Protection Act of 1996 (SBJP Act), Pub. L. 104–188, 110 Stat. 1755. Whereas the "control test" of section 7701(a)(30)(E)(ii), as enacted by the SBJP Act, contains a relatively bright-line test for purposes of determining a trust's status, thereby necessitating the inadvertent migration rule of §301.7701–7(d)(2), the determination of domestic or foreign status prior to the SBJP Act was governed by less objective criteria.

Under pre-SBJP Act law, an inadvertent short-term replacement of a domestic trustee by a foreign trustee would not necessarily cause a change in the trust's status. Accordingly, a specific inadvertent migration rule for §301.7701–7(f) is not appropriate. Instead, as set forth in §301.7701–7(f)(4)(ii), an election under §301.7701–7(f) will not be terminated unless the trust has no reasonable basis for being treated as a domestic trust under pre-SBJP Act law.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Karen A. Rennie-Quarrie of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.684–1 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–2 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–3 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–4 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–5 also issued under 26 U.S.C. 643(a)(7) and 684(a). * * *

Par. 2. Sections 1.684–1, 1.684–2, 1.684–3, 1.684–4 and 1.684–5 are added under the undesignated centerheading "Miscellaneous" to read as follows:

§1.684–1 Recognition of gain on transfers to certain foreign trusts and estates.

(a) *Immediate recognition of gain*—(1) *In general*. Any U.S. person who transfers property to a foreign trust or foreign estate shall be required to recognize gain at the time of the transfer equal to the excess of the fair market value of the property transferred over the adjusted basis (for purposes of determining gain) of such property in the hands of the U.S. transferor unless an exception applies under the provisions of §1.684–3. The amount of gain recognized is determined on an asset-by-asset basis.

(2) *No recognition of loss*. Under this section a U.S. person may not recognize loss on the transfer of an asset to a foreign trust or foreign estate. A U.S. person may not offset gain realized on the transfer of an appreciated asset to a foreign trust or foreign estate by a loss realized on the transfer of a depreciated asset to the foreign trust or foreign estate.

(b) *Definitions*. The following definitions apply for purposes of this section:

(1) *U.S. person*. The term *U.S. person* means a United States person as defined in section 7701(a)(30), and includes a nonresident alien individual who elects under section 6013(g) to be treated as a resident of the United States.

(2) *U.S. transferor*. The term *U.S. transferor* means any U.S. person who makes a transfer (as defined in §1.684–2) of property to a foreign trust or foreign estate.

(3) *Foreign trust*. Section 7701(a)(31)(B) defines foreign trust. See also §301.7701–7 of this chapter.

(4) *Foreign estate*. Section 7701(a)(31)(A) defines foreign estate.

(c) *Reporting requirements*. A U.S. person who transfers property to a foreign

trust or foreign estate must comply with the reporting requirements under section 6048.

(d) *Examples*. The following examples illustrate the rules of this section. In all examples, *A* is a U.S. person and *FT* is a foreign trust. The examples are as follows:

Example 1. Transfer to foreign trust. *A* transfers property that has a fair market value of 1000X to *FT*. *A*'s adjusted basis in the property is 400X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes gain at the time of the transfer equal to 600X.

Example 2. Transfer of multiple properties. *A* transfers property Q, with a fair market value of 1000X, and property R, with a fair market value of 2000X, to *FT*. At the time of the transfer, *A*'s adjusted basis in property Q is 700X, and *A*'s adjusted basis in property R is 2200X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes the 300X of gain attributable to property Q. Under paragraph (a)(2) of this section, *A* does not recognize the 200X of loss attributable to property R, and may not offset that loss against the gain attributable to property Q.

Example 3. Transfer for less than fair market value. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for 400X of cash. *A*'s adjusted basis in the property is 200X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes gain at the time of the transfer equal to 800X.

Example 4. Exchange of property for private annuity. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for *FT*'s obligation to pay *A* 50X per year for the rest of *A*'s life. *A*'s adjusted basis in the property is 100X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. *A* is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though *A* might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code.

Example 5. Transfer of property to related foreign trust in exchange for qualified obligation. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for *FT*'s obligation to make payments to *A* during the next four years. *FT* is related to *A* as defined in §1.679–1(c)(5). The obligation is treated as a qualified obligation within the meaning of §1.679–4(d), and no person is treated as owning any portion of *FT*. *A*'s adjusted basis in the property is 100X. *A* is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though *A* might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code. Section 1.684–3(d) provides rules relating to transfers for fair market value to unrelated foreign trusts.

§1.684–2 Transfers.

(a) *In general*. A transfer means a direct, indirect, or constructive transfer.

(b) *Indirect transfers*—(1) *In general*. Section 1.679–3(c) shall apply to determine if a transfer to a foreign trust or foreign estate, by any person, is treated as an indirect transfer by a U.S. person to the foreign trust or foreign estate.

(2) *Examples*. The following examples illustrate the rules of this paragraph (b). In all examples, *A* is a U.S. citizen, *FT* is a foreign trust, and *I* is *A*'s uncle, who is a nonresident alien. The examples are as follows:

Example 1. Principal purpose of tax avoidance. *A* creates and funds *FT* for the benefit of *A*'s cousin, who is a nonresident alien. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. In 2004, *A* decides to transfer additional property with a fair market value of 1000X and an adjusted basis of 600X to *FT*. Pursuant to a plan with a principal purpose of avoiding the application of section 684, *A* transfers the property to *I*. *I* subsequently transfers the property to *FT*. Under paragraph (b) of this section and §1.679–3(c), *A* is treated as having transferred the property to *FT*.

Example 2. U.S. person unable to demonstrate that intermediary acted independently. *A* creates and funds *FT* for the benefit of *A*'s cousin, who is a nonresident alien. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. On July 1, 2004, *A* transfers property with a fair market value of 1000X and an adjusted basis of 300X to *I*, a foreign person. On January 1, 2007, at a time when the fair market value of the property is 1100X, *I* transfers the property to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, under §1.679–3(c)(2)(ii), that *I* acted independently of *A* in making the transfer to *FT*. Under paragraph (b) of this section and §1.679–3(c), *A* is treated as having transferred the property to *FT*. Under paragraph (b) of this section and §1.679–3(c)(3), *I* is treated as an agent of *A*, and the transfer is deemed to have been made on January 1, 2007. Under §1.684–1(a), *A* recognizes gain equal to 800X on that date.

(c) *Constructive transfers*. Section 1.679–3(d) shall apply to determine if a transfer to a foreign trust or foreign estate is treated as a constructive transfer by a U.S. person to the foreign trust or foreign estate.

(d) *Transfers by certain trusts*—(1) *In general*. If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Examples*. The following examples illustrate the rules of this paragraph (d). In all examples, *A* is a U.S. person, *DT* is a domestic trust, and *FT* is a foreign trust. The examples are as follows:

Example 1. Transfer by a domestic trust. On January 1, 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis of 200X to *DT*. *A* retains the power to revoke *DT*. On January 1, 2003, *DT* transfers property which has a fair market value of 500X and an adjusted basis of 100X to *FT*. At the time of the transfer, *FT* has no U.S. beneficiary as defined in §1.679–2 and no person is treated as owning any portion of *FT*. *A* is treated as having transferred the property to *FT* and is required to recognize gain of 400X, under §1.684–1, at the time of the transfer by *DT* to *FT*.

Example 2. Transfer by a foreign trust. On January 1, 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis of 200X to *FT1*. At the time of the transfer, *FT1* has a U.S. beneficiary as defined in §1.679–2 and *A* is treated as the owner of *FT1* under section 679. On January 1, 2003, *FT1* transfers property which has a fair market value of 500X and an adjusted basis of 100X to *FT2*. At the time of the transfer, *FT2* has no U.S. beneficiary as defined in §1.679–2 and no person is treated as owning any portion of *FT2*. *A* is treated as having transferred the property to *FT2* and is required to recognize gain of 400X, under §1.684–1, at the time of the transfer by *FT1* to *FT2*.

(e) *Deemed transfers when foreign trust no longer treated as owned by a U.S. person*—(1) *In general*. If any portion of a foreign trust is treated as owned by a U.S. person under subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, and such portion ceases to be treated as owned by that person under such subpart (other than by reason of an actual transfer of property from the trust to which §1.684–2(d) applies), the U.S. person shall be treated as having transferred, immediately before (but on the same date that) the trust is no longer treated as owned by that U.S. person, the assets of such portion to a foreign trust.

(2) *Examples*. The following examples illustrate the rules of this paragraph (e). In all examples, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

Example 1. Loss of U.S. beneficiary. (i) On January 1, 2001, *A* transfers property, which has a fair market value of 1000X and an adjusted basis of 400X, to *FT*. At the time of the transfer, *FT* has a U.S. beneficiary within the meaning of §1.679–2, and *A* is treated as owning *FT* under section 679. Under §1.684–3(a), §1.684–1 does not cause *A* to recognize gain at the time of the transfer.

(ii) On July 1, 2003, *FT* ceases to have a U.S. beneficiary as defined in §1.679–2(c) and as of that date neither *A* nor any other person is treated as owning any portion of *FT*. Pursuant to §1.679–2(c)(2), if *FT* ceases to be treated as having a U.S. beneficiary, *A* will cease to be treated as

owner of *FT* beginning on the first day of the first taxable year following the last taxable year in which there was a U.S. beneficiary. Thus, on January 1, 2004, *A* ceases to be treated as owner of *FT*. On that date, the fair market value of the property is 1200X and the adjusted basis is 350X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* on January 1, 2004, and must recognize 850X of gain at that time under §1.684–1.

Example 2. Death of grantor. (i) The initial facts are the same as in paragraph (i) of *Example 1*.

(ii) On July 1, 2003, *A* dies, and as of that date no other person is treated as the owner of *FT*. On that date, the fair market value of the property is 1200X, and its adjusted basis equals 350X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* immediately before his death, and generally is required to recognize 850X of gain at that time under §1.684–1. However, an exception may apply under §1.684–3(c).

Example 3. Release of a power. (i) On January 1, 2001, *A* transfers property that has a fair market value of 500X and an adjusted basis of 200X to *FT*. At the time of the transfer, FT does not have a U.S. beneficiary within the meaning of §1.679–2. However, *A* retains the power to revoke the trust. *A* is treated as the owner of the trust under section 676 and, therefore, under §1.684–3(a), *A* is not required to recognize gain under §1.684–1 at the time of the transfer.

(ii) On January 1, 2007, *A* releases the power to revoke the trust and, as of that date, neither *A* nor any other person is treated as owning any portion of FT. On that date, the fair market value of the property is 900X, and its adjusted basis is 200X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* on January 1, 2007, and must recognize 700X of gain at that time.

(f) *Transfers to entities owned by a foreign trust*. Section 1.679–3(f) provides rules that apply with respect to transfers of property by a U.S. person to an entity in which a foreign trust holds an ownership interest.

§1.684–3 Exceptions to general rule of gain recognition.

(a) *Transfers to grantor trusts*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property by a U.S. person to a foreign trust to the extent that any person is treated as the owner of the trust under section 671. Section 1.684–2(e) provides rules regarding a subsequent change in the status of the trust.

(b) *Transfers to charitable trusts*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property to a foreign trust that is described in section 501(c)(3) (without regard to the requirements of section 508(a)).

(c) *Certain transfers at death*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property by reason of death of the U.S. transferor if the basis of the property in the hands of the foreign trust is determined under section 1014(a).

(d) *Transfers for fair market value to unrelated trusts*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property for fair market value to a foreign trust that is not a related foreign trust as defined in §1.679–1(c)(5). Section 1.671–2(e)(2)(ii) defines fair market value.

(e) *Transfers to which section 1032 applies*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of stock (including treasury stock) by a domestic corporation to a foreign trust if the domestic corporation is not required to recognize gain on the transfer under section 1032.

(f) *Certain distributions to trusts*. For purposes of this section, a transfer does not include 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.

(g) *Examples*. The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

Example 1. Transfer to owner trust. In 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *FT*. At the time of the transfer, *FT* has a U.S. beneficiary within the meaning of §1.679–2, and *A* is treated as owning *FT* under section 679. Under paragraph (a) of this section, §1.684–1 does not cause *A* to recognize gain at the time of the transfer. See §1.684–2(e) for rules that may require *A* to recognize gain if the trust is no longer owned by *A*.

Example 2. Transfer of property at death: Basis determined under section 1014(a). (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retained the power to revoke *FT*, thus, the value of all property owned by *FT* at *A*'s death is includible in *A*'s gross estate for U.S. estate tax purposes. Pursuant to paragraph (c) of this section, *A* is not required to recognize gain under §1.684–1 because the basis of the property in the hands of the foreign trust is determined under section 1014(a).

Example 3. Transfer of property at death: Basis not determined under section 1014(a). (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retains no power over *FT*, and *FT*'s basis in the property transferred is not determined under section 1014(a). Under §1.684–2(e)(1), *A* is treated as having transferred the property to *FT* immediately before his death, and must recognize 1100X of gain at that time under §1.684–1.

Example 4. Transfer of property for fair market value to an unrelated foreign trust. A sells a house with a fair market value of 1000X to *FT* in exchange for a 30-year note issued by *FT*. *A* is not related to *FT* as defined in §1.679–1(c)(5). *FT* is not treated as owned by any person. Pursuant to paragraph (d) of this section, *A* is not required to recognize gain under §1.684–1.

§1.684–4 Outbound migrations of domestic trusts.

(a) *In general*. If a U.S. person transfers property to a domestic trust, and such trust becomes a foreign trust, and neither trust is treated as owned by any person under subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, the trust shall be treated for purposes of this section as having transferred all of its assets to a foreign trust and the trust is required to recognize gain on the transfer under §1.684–1(a). The trust must also comply with the rules of section 6048.

(b) *Date of transfer*. The transfer described in this section shall be deemed to occur immediately before, but on the same date that, the trust meets the definition of a foreign trust set forth in section 7701(a)(31)(B).

(c) *Inadvertent migrations*. In the event of an inadvertent migration, as defined in §301.7701–7(d)(2) of this chapter, a trust may avoid the application of this section by complying with the procedures set forth in §301.7701–7(d)(2) of this chapter.

(d) *Examples*. The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen, *B* is a U.S. citizen, *C* is a nonresident alien, and *T* is a trust. The examples are as follows:

Example 1. Migration of domestic trust with U.S. beneficiaries. A transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust, for the benefit of *A*'s children who are also U.S. citizens. *B* is the trustee of *T*. On January 1, 2001, while *A* is still alive, *B* resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701–7(d) of this chapter, *T* becomes a foreign trust. *T* has U.S. beneficiaries within the meaning of

§1.679–2 and *A* is, therefore, treated as owning *FT* under section 679. Pursuant to §1.684–3(a), neither *A* nor *T* is required to recognize gain at the time of the migration. Section 1.684–2(e) provides rules that may require *A* to recognize gain upon a subsequent change in the status of the trust.

Example 2. Migration of domestic trust with no U.S. beneficiaries. *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust for the benefit of *A*'s mother who is not a citizen or resident of the United States. *T* is not treated as owned by another person. *B* is the trustee of *T*. On January 1, 2001, while *A* is still alive, B resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701–7(d) of this chapter, *T* becomes a foreign trust, *FT*. *FT* has no U.S. beneficiaries within the meaning of §1.679–2 and no person is treated as owning any portion of *FT*. *T* is required to recognize gain of 600X on January 1, 2001. Paragraph (c) of this section provides rules with respect to an inadvertent migration of a domestic trust.

§1.684–5 Effective date

Sections 1.684–1 through 1.684–4 apply to transfers of property to foreign trusts and foreign estates after August 7, 2000.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 9, 2001.

Mark Weinberger,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 19, 2001, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2001, 66 F.R. 37897)

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 809.—Reduction in Certain Deductions of Mutual Life Insurance Companies

26 CFR 1.809–9: Computation of the differential earnings rate and the recomputed differential earnings rate.

Mutual life insurance companies; differential earnings rate. The differential earnings rate for 2000 and the recomputed differential earnings rate for 1999 are set forth for use by mutual life insurance companies to compute their income tax liabilities for 2000.

Rev. Rul. 2001–33

This revenue ruling contains the differential earnings rate for 2000 and the recomputed differential earnings rate for 1999. Under § 809 of the Internal Revenue Code, mutual life insurance companies use these rates in computing their federal income tax liability for taxable years beginning in 2000. This revenue ruling also contains the figures on which the determinations of these rates are based. Notice 2001–24, 2001–12 I.R.B. 912, contained tentative determinations of these rates.

Section 809(a) provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under § 808 for policyholder dividends is reduced (but not below zero) by the "differential earnings amount." Any excess of the differential earnings amount over the amount of the deduction allowable under § 808 is taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of § 807. The "differential earnings amount" for any taxable year is the amount equal to the product of (a) the life insurance company's average equity base for the taxable year multiplied by (b) the "differential earnings rate" for that taxable year. The "differential earnings rate" for the taxable year is the excess of (a) the "imputed earnings rate" for the taxable year over (b) the "average mutual earnings rate" for the second calendar year preceding the calendar year in which the taxable year begins. The "imputed earnings rate" for any taxable year is the amount that bears the same ratio to 16.5 percent as the "current stock earnings rate" for the taxable year bears to the "base period stock earnings rate."

Section 809(f) provides that, in the case of any mutual life insurance company, if the "recomputed differential earnings amount" for any taxable year exceeds the differential earnings amount for that taxable year, the excess is included in life insurance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for that taxable year, the excess is allowed as a life insurance deduction for the succeeding taxable year. The "recomputed differential earnings amount" for any taxable year is an amount calculated in the same manner as the differential earnings amount for that taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

The stock earnings rates and mutual earnings rates taken into account under § 809 generally are determined by dividing statement gain from operations by the average equity base. For this purpose, the term "statement gain from operations" means "the net gain or loss from operations required to be set forth in the annual statement, determined without regard to federal income taxes, and ... properly adjusted for realized capital gains and losses...." *See* § 809(g)(1). The term "equity base" is defined as an amount determined in the manner prescribed by regulations equal to surplus and capital increased by the amount of nonadmitted financial assets, the excess of the amount of statutory reserves over the amount of tax reserves, the sum of certain other reserves, and 50 percent of any policyholder dividends (or other similar liability) payable in the following taxable year. *See* § 809(b)(2), (3), (4), (5), and (6). Section 1.809–10 of the Income Tax Regulations provides that the equity base includes both the asset valuation reserve and the interest maintenance reserve for taxable years ending after December 31, 1991.

Section 1.809–9(a) of the regulations provides that neither the differential earnings rate under § 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under § 809(f)(3) may be less than zero.

Rev. Rul. 99–3, 1999–1 C.B. 313, provides that a life insurance subsidiary of a mutual holding company is not a mutual life insurance company for which the deduction for policyholder dividends is reduced pursuant to §§ 808(c)(2) and 809.

For purposes of § 809, the differential earnings rate for 2000 and the rate used to calculate the recomputed differential earnings amount for 1999 (the recomputed differential earnings rate for 1999), and the figures on which these two rates are based are set forth in Table 1.

Rev. Rul. 2001–33 Table 1

Determination of Rates To Be Used For Taxable Years Beginning in 2000

Differential earnings rate for 2000	0
Recomputed differential earnings rate for 1999	0
Imputed earnings rate for 1999	15.815
Imputed earnings rate for 2000	15.358
Base period stock earnings rate	18.221
Current stock earnings rate for 2000	16.960
Stock earnings rate for 1997	19.321
Stock earnings rate for 1998	15.836
Stock earnings rate for 1999	15.724
Average mutual earnings rate for 1998	16.011
Average mutual earnings rate for 1999	16.164

DRAFTING INFORMATION

The principal author of this revenue ruling is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Ms. Hossofsky at (202) 622-3477 (not a toll-free number).

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for August 2001.

Rev. Rul. 2001–36

This revenue ruling provides various prescribed rates for federal income tax purposes for August 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2001–36 TABLE 1

Applicable Federal Rates (AFR) for August 2001

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	3.94%	3.90%	3.88%	3.87%
110% AFR	4.34%	4.29%	4.27%	4.25%
120% AFR	4.73%	4.68%	4.65%	4.64%
130% AFR	5.13%	5.07%	5.04%	5.02%
Mid-Term				
AFR	4.99%	4.93%	4.90%	4.88%
110% AFR	5.49%	5.42%	5.38%	5.36%
120% AFR	6.01%	5.92%	5.88%	5.85%
130% AFR	6.51%	6.41%	6.36%	6.33%
150% AFR	7.54%	7.40%	7.33%	7.29%
175% AFR	8.82%	8.63%	8.54%	8.48%
Long-Term				
AFR	5.72%	5.64%	5.60%	5.57%
110% AFR	6.30%	6.20%	6.15%	6.12%
120% AFR	6.88%	6.77%	6.71%	6.68%
130% AFR	7.46%	7.33%	7.26%	7.22%

REV. RUL. 2001–36 TABLE 2

Adjusted AFR for August 2001

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.01%	2.99%	2.98%	2.97%
Mid-term adjusted AFR	3.83%	3.79%	3.77%	3.76%
Long-term adjusted AFR	4.94%	4.88%	4.85%	4.83%

REV. RUL. 2001–36 TABLE 3

Rates Under Section 382 for August 2001

Adjusted federal long-term rate for the current month	4.94%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.01%

REV. RUL. 2001–36 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for August 2001

Appropriate percentage for the 70% present value low-income housing credit	8.25%
Appropriate percentage for the 30% present value low-income housing credit	3.54%

REV. RUL. 2001–36 TABLE 5

Rate Under Section 7520 for August 2001

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	6.0%

Section 1288.—Treatment of Original Issue Discounts on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Section 7872.—Treatment of Loans with Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

Part III. Administrative, Procedural, and Miscellaneous

Extension of Relief Relating to Application of Nondiscrimination Rules for Certain Church Plans and Governmental Plans

Notice 2001–46

I. PURPOSE

This notice provides relief from the application of the nondiscrimination requirements of the Internal Revenue Code for certain church and governmental plans.

In particular, this notice extends the effective date of regulations under §§ 401(a)(4), 401(a)(5), 401(l), and 414(s) of the Internal Revenue Code for nonelecting church plans until further notice, but in no case earlier than the first plan year beginning on or after January 1, 2003.

In addition, this notice provides that certain governmental plans shall be deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) of the Code until the first day of the first plan year beginning on or after January 1, 2003. In accordance with this relief, the regulations relating to these provisions do not apply until plan years beginning on or after that date. This relief is available with respect to governmental plans within the meaning of § 414(d) other than plans of State and local governments or political subdivisions, agencies or instrumentalities thereof.

II. BACKGROUND

A. Church Plans

Section 414(e)(1) of the Code provides in general that the term "church plan" means a plan established and maintained for its employees (and their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under § 501. Pursuant to § 410(d), a church or convention or association of churches that maintains any church plan may make an election under § 410(d) to have certain Code provisions relating to participation, vesting, and funding, etc., apply to such church plan as if such provisions did not contain an exclusion for church plans. A church plan for which such an election has not been made (a "nonelecting church plan") is not subject to these provisions.

Notice 2001–9, 2001–4 I.R.B. 375, provided that the regulations under §§ 401(a)(4), 401(a)(5), 401(l) and 414(s) would apply for nonelecting church plans in plan years beginning on or after January 1, 2002. For plan years beginning before that effective date, nonelecting church plans must be operated in accordance with a reasonable, good faith interpretation of these statutory provisions.

B. Governmental Plans

Section 414(d) of the Code provides that the term "governmental plan" means a plan established and maintained for its employees by the government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term "governmental plan" also includes any plan to which the Railroad Retirement Act of 1935 or 1937 (the "Act") applies and which is financed by contributions under that Act and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act (59 Stat. 669).

Section 1505 of the Taxpayer Relief Act of 1997 ("TRA '97") generally provides that the nondiscrimination rules do not apply to State and local governmental plans. In particular, § 1505 amended the Code to provide that §§ 401(a)(3), 401(a)(4), and 401(a)(26) shall not apply to such plans. Section 1505 of TRA '97 amended § 401(k) of the Code to provide that State and local governmental plans shall be treated as meeting the requirements of § 401(k)(3). In addition, § 1505(a)(3) of TRA '97 amended § 410(c) of the Code to provide that governmental plans shall be treated as meeting the requirements of § 410 for purposes of § 401(a). This amendment to § 410(c), by its terms, is not limited to State and local governmental plans but applies to all governmental plans within the meaning of § 414(d).

Notice 2001–9 provided that governmental plans, other than plans maintained by State or local governments or political subdivisions or instrumentalities thereof, would be deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) of the Internal Revenue Code until the first day of the first plan year beginning on or after January 1, 2002. The notice also provided that the regulations relating to these provisions would not apply until plan years beginning on or after that date.

III. EXTENSION OF EFFECTIVE DATE OF NONDISCRIMINATION REGULATIONS FOR NON-ELECTING CHURCH PLANS

The regulations under §§ 401(a)(4), 401(a)(5), 401(l), and 414(s) shall not apply to nonelecting church plans until further notice, but in no case earlier than the first plan year beginning on or after January 1, 2003. Nonelecting church plans must be operated in accordance with a reasonable, good faith interpretation of these statutory provisions until the time such notice is provided.

IV. EXTENSION OF RELIEF RELATING TO APPLICATION OF NONDISCRIMINATION RULES FOR CERTAIN GOVERNMENTAL PLANS

Under the relief provided by this notice, governmental plans within the meaning of § 414(d), other than those maintained by State or local governments or political subdivisions, agencies or instrumentalities thereof, shall be treated as satisfying the requirements of §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) until the first plan year beginning on or after January 1, 2003. In accordance with this relief, the regulations under §§ 401(a)(4), 401(a)(26), 401(m), 410(b) and 414(s), and the regulations implementing § 401(k)(3), shall apply to governmental plans described in this section IV only for plan years beginning on or after January 1, 2003.

V. EFFECT ON OTHER DOCUMENTS

Notice 2001–9 is modified.

DRAFTING INFORMATION

The principal author of this notice is Diane S. Bloom of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Bloom may be reached at (202) 283-9888. These telephone numbers are not toll-free.

Part IV. Items of General Interest

Additional Model Amendment for Retirement Plans for Proposed Regulations under Section 401(a)(9)

Announcement 2001–82

Proposed regulations under section 401(a)(9) of the Internal Revenue Code, relating to required minimum distributions from retirement plans, were published in the Federal Register on January 17, 2001 (the 2001 Proposed Regulations) and in the Internal Revenue Bulletin at 2001–11 I.R.B. 865. The preamble to the 2001 Proposed Regulations states that taxpayers may rely on regulations under § 401(a)(9) that were proposed in 1987 (the 1987 Proposed Regulations) or the 2001 Proposed Regulations for determining required minimum distributions for calendar year 2001 and subsequent calendar years prior to the effective date of the final regulations.

The preamble to the 2001 Proposed Regulations contains a model amendment that qualified plan sponsors can adopt if they wish to apply the 2001 Proposed Regulations in making all required minimum distributions for 2001 and subsequent calendar years prior to the effective date of the final regulations. After publication in the Federal Register, the model amendment was republished in Announcement 2001–18, 2001–10 I.R.B. 791, with minor corrections, and appeared (as corrected) in the preamble to the 2001 Proposed Regulations (REG–130477–00; REG–130481–00, 2001–11 I.R.B. 865).

This announcement responds to concerns by qualified plan sponsors that intended to use the 2001 Proposed Regulations for distributions for 2001 but made required minimum distributions for 2001 under the 1987 Proposed Regulations prior to the date on which the plan began operating under the 2001 Proposed Regulations. Qualified plan sponsors may adopt the alternative model amendment provided below in order to allow required minimum distributions made for 2001 prior to the date on which the plan began operating under the 2001 Proposed Regulations to be made under the 1987 Proposed Regulations. Required minimum distributions made on or after the effective date of the amendment for 2001 will be made under the 2001 Proposed Regulations. The alternative model amendment also provides that, if the total amount of 2001 required minimum distributions made to a participant prior to the date on which the plan began operating in accordance with the 2001 Proposed Regulations are equal to or greater than the required minimum distributions determined under the 2001 Proposed Regulations, then no additional distributions are required for that participant for 2001 on or after such date. If the total amount of required minimum distributions made to a participant for 2001 prior to the date on which the plan began operating under the 2001 Proposed Regulations are less than the amount determined under the 2001 Proposed Regulations, then required minimum distributions for 2001 following such date will be determined so that the total amount of required minimum distributions for 2001 for that participant is the amount determined under the 2001 Proposed Regulations.

The model amendment described above is as follows:

> With respect to distributions under the Plan made on or after ***[SPECIFY DATE ON WHICH THE PLAN BEGAN OPERATING IN ACCORDANCE WITH THE 2001 PROPOSED REGULATIONS]*** for calendar years beginning on or after January 1, 2001, the Plan will apply the minimum distribution requirements of section 401(a)(9) of the Internal Revenue Code in accordance with the regulations under section 401(a)(9) that were proposed on January 17, 2001 (the 2001 Proposed Regulations), notwithstanding any provision of the Plan to the contrary. If the total amount of required minimum distributions made to a participant for 2001 prior to ***[SPECIFY DATE ON WHICH THE PLAN BEGAN OPERATING IN ACCORDANCE WITH THE 2001 PROPOSED REGULATIONS]*** are equal to or greater than the amount of required minimum distributions determined under the 2001 Proposed Regulations, then no additional distributions are required for such participant for 2001 on or after such date. If the total amount of required minimum distributions made to a participant for 2001 prior to ***[SPECIFY DATE ON WHICH THE PLAN BEGAN OPERATING IN ACCORDANCE WITH THE 2001 PROPOSED REGULATIONS]*** are less than the amount determined under the 2001 Proposed Regulations, then the amount of required minimum distributions for 2001 on or after such date will be determined so that the total amount of required minimum distributions for 2001 is the amount determined under the 2001 Proposed Regulations. This amendment shall continue in effect until the last calendar year beginning before the effective date of the final regulations under section 401(a)(9) or such other date as may be published by the Internal Revenue Service.

A plan sponsor that made required minimum distributions for 2001 under the 1987 Proposed Regulations prior to the date during 2001 that it began operating under the 2001 Proposed Regulations must amend its plan in accordance with the model amendment set forth above. The above model amendment may be used only if it is effective on a date in 2001 when the plan begins to operate in accordance with the 2001 Proposed Regulations. The original model amendment contained in Announcement 2001–18 is available for plans that follow the 2001 Proposed Regulations for determining required minimum distributions for 2001 for the entire calendar year 2001 or, if first effective after 2001, for later calendar years prior to the effective date of the final regulations.

In order for a qualified plan sponsor to use either model amendment, it must adopt the amendment prior to the end of the plan's GUST remedial amendment period. Revenue Procedure 2000–27, 2000–26 I.R.B. 1272, extends the GUST remedial amendment period for most plans until the end of the first plan year beginning on or after January 1, 2001.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified,* below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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