

## 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

#### **REG-251703-96, page 5.**

Proposed regulations under section 7701 of the Code provide guidance relating to the definition of a trust as a United States person (domestic trust) or foreign trust. A public hearing will be held on September 16, 1997.

#### **REG-252487-96, page 9.**

Proposed regulations under section 672 of the Code relate to the application of the grantor trust rules to certain trusts established by foreign persons. A public hearing will be held on August 27, 1997.

### EMPLOYEE PLANS

#### **Notice 97-35, page 32.**

**Weighted average interest rate update.** Guidelines are set forth for determining for June 1997, the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code as amended by the Omnibus Budget Reconciliation Act of 1987 and by the Uruguay Round Agreements Act (GATT).

### EXEMPT ORGANIZATIONS

#### **Announcement 97-62, page 34.**

A list is given of organizations now classified as private foundations.

### ADMINISTRATIVE

#### **Rev. Proc. 97-30, page 20.**

**Election of general asset accounts.** An automatic consent procedure is provided for electing general asset accounts for depreciable property placed in service in prior years. Rev. Proc. 97-27 modified.

#### **Del. Order 232 (Rev. 3), page 21.**

The authority to issue Taxpayer Assistance Orders (TAOs) under IRC section 7811 is delegated to certain officials. Del. Order 232 (Rev. 2) superseded.

#### **Notice 97-34, page 22.**

This notice provides guidance regarding the new foreign trust and foreign gift reporting provisions contained in the Small Business Job Protection Act of 1996.

## **Mission of the Service**

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the

quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

## **Statement of Principles of Internal Revenue Tax Administration**

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

# 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 of a permanent nature are consolidated semi-annually 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 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.**

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

### Section 168.—Accelerated Cost Recovery System

May a taxpayer make a general asset account election in the current taxable year for depreciable property placed in service in a prior taxable year? See Rev. Proc. 97-30, page 20.

*26 CFR 1.168(i)-1: General asset accounts.*

May a taxpayer make a general asset account election in the current taxable year for depreciable property placed in service in a prior taxable year? See Rev. Proc. 97-30, page 20.

### Section 446.—General Rule for Methods of Accounting

If a taxpayer makes a general asset account election in the current taxable year for depreciable property placed in service in a prior taxable year, is this election a change in method of accounting? See Rev. Proc. 97-30, page 20.

*26 CFR 1.446-1: General rule for methods of accounting.*

If a taxpayer makes a general asset account election in the current taxable year for depreciable

property placed in service in a prior taxable year, is this election a change in method of accounting? See Rev. Proc. 97-30, page 20.

### Section 481.—Adjustments Required by Changes in Method of Accounting

If a taxpayer makes a general asset account election in the current taxable year for depreciable property placed in service in a prior taxable year, does this change in method of accounting require an adjustment under §§ 481(a)? See Rev. Proc. 97-30, page 20.

### Part III. Administrative, Procedural, and Miscellaneous

#### Notice of Proposed Rulemaking and Notice of Public Hearing

#### Residence of Trusts and Estates—7701

REG-251703-96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations providing guidance relating to the definition of a trust as a United States person (domestic trust) or foreign trust. The proposed regulations reflect changes to the law made by the Small Business Job Protection Act of 1996 and affect the determination of the residency of trusts for federal tax purposes. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by August 4, 1997. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for September 16, 1997, at 10 a.m. must be submitted by August 26, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-251703-96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-251703-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The public hearing will be held in the Internal Revenue Service Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, James A. Quinn or Eliana Dolgoff, (202) 622-3060; concerning submissions and the hearing, Evangelista Lee, (202) 622-7190 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Section 1907 of the Small Business Job Protection Act of 1996 (the Act), Public Law 104-188, 110 Stat. 1755 (August 20, 1996) amended sections 7701(a)(30) and (31) to provide a new rule for determining whether a trust is domestic or foreign (the new rule does not apply to estates), effective for tax years beginning after December 31, 1996, or at the election of the trustee of a trust to tax years ending after August 20, 1996. Section 7701(a)(30)(E) provides that the term *United States person* means any trust if (i) a court within the United States is able to exercise primary supervision over the administration of the trust (court test), and (ii) one or more United States fiduciaries have the authority to control all substantial decisions of the trust (control test). Section 7701(a)(31)(B) provides that the term *foreign trust* means any trust other than a trust described in section 7701(a)(30)(E).

Prior to the Act, section 7701(a)(31) provided that *foreign estate* and *foreign trust* mean an estate or trust, as the case may be, the income of which, from sources without the United States, which is not effectively connected with the conduct of a trade or business within the United States, is not includable in gross income under subtitle A. Accordingly, whether a trust was domestic or foreign depended on whether the trust was more comparable to a resident or nonresident alien individual. Thus, it was necessary to consider and weigh various factors such as the location of the assets, the country under whose laws the trust was created, the residence of the fiduciary, the nationality of the decedent or settlor, the nationality of the beneficiaries, and the location of the administration of the trust. See Rev. Rul. 60-181 (1960-1 C.B. 257), citing *B.W. Jones Trust v. Commissioner*, 46 B.T.A. 531 (1942), aff'd, 132 F.2d 914 (4th Cir. 1943).

The Act made a number of procedural and substantive changes to the tax treatment of foreign trusts that were designed to improve tax compliance and administration. In making these overall changes, Congress believed that it would be appropriate to have an objective test for determining whether a trust is foreign or domestic. Consequently, it enacted the two-part test set forth above.

##### Explanation of Provisions

The proposed regulations provide that a foreign trust is taxed in the same manner as a nonresident alien. Thus, once a trust is determined to be a foreign trust, the residency of the fiduciary of the trust is not relevant in determining the residence of the trust. Additionally, section 7701(b) does not apply to determine whether a trust is a resident of the United States, and a foreign trust is not present in the United States for purposes of section 871(a)(2).

The proposed regulations require that the terms of the trust instrument and applicable law be applied to determine whether the court test and the control test are met. The residency of a trust may change if the result of the court test or control test changes.

##### The Safe Harbor

The IRS and Treasury Department were concerned that the lack of authority construing trust law in many states would make it difficult for taxpayers to determine whether a trust is domestic or foreign under the court and control tests. Specifically, it may be difficult to determine whether the court of a particular state would assert primary supervision over the administration of a trust if that trust had never appeared before a court. Therefore, the proposed regulations provide a safe harbor based upon the principle that when the administration of a trust is conducted entirely within a particular locality, the local courts will exercise primary supervision over the trust. Restatement (2d) of Conflicts of Laws § 267. The safe harbor provides that a trust is a domestic trust if, pursuant to the terms of a trust instrument, the trust has only United States fiduciaries, such fiduciaries are administering the trust exclusively in the United States, and the trust is not subject to an automatic migration provision. The IRS and Treasury Department request comments on whether this special rule is sufficient to address the lack of a well-developed body of local law.

##### The Court Test

The proposed regulations define the relevant terms for purposes of the court test. The term court includes any federal, state, or local court.

The term *the United States* includes only the States and the District of Columbia. Accordingly, a court within a

territory or possession of the United States or within a foreign country is not a court within the United States and a trust subject to the primary supervision of such a court fails to meet the court test. The IRS and Treasury Department request comments on the conclusion that the term *the United States* is used in its geographical sense and therefore excludes territories and possessions.

The term *is able to exercise* means that if petitioned, a court has or would have the authority under applicable law to render orders or judgments resolving issues concerning administration of the trust.

The term *primary supervision* means that a court has or would have the authority to determine substantially all issues regarding the administration of the trust. Simply having jurisdiction over the trustee, a beneficiary, or trust property is not primary supervision.

The term *administration* of the trust means the carrying out of the duties imposed on a fiduciary by the terms of the trust instrument and applicable law.

In order to provide certainty to taxpayers, the proposed regulations provide some bright-line rules for satisfying the court test. A trust meets the court test if an authorized fiduciary registers the trust in a court within the United States under a state statute that has provisions substantially similar to Article VII, *Trust Administration*, of the Uniform Probate Code.

In the case of a testamentary trust established under a will probated within the United States, if all fiduciaries of the trust have been qualified as trustees of the trust by a court within the United States, the trust meets the court test.

In the case of an inter vivos trust, if the fiduciaries or beneficiaries take steps with a court within the United States (such as the filing of a written request with the court) that cause the administration of the trust to be subject to the primary supervision of the court, the trust meets the court test.

The proposed regulations clarify that if both a United States court and a foreign court are able to exercise primary supervision over the administration of the trust, the trust will be considered to meet the court test.

The proposed regulations contain rules addressing automatic migration clauses, also known as "flee clauses." The proposed regulations provide that the court test is not met if a United States court's attempt to assert jurisdiction or otherwise supervise the adminis-

tration of the trust directly or indirectly would cause the trust to migrate from the United States.

#### *The Control Test*

The control test requires that one or more United States fiduciaries have the authority to control all substantial decisions of the trust. Under the proposed regulations, the term fiduciary refers to any person described in section 7701(a)(6) and § 301.7701-6(b). For purposes of the control test, any other person that has the power to control substantial decisions of the trust, for example a trust protector, will also be treated as a fiduciary. The proposed regulations treat such persons as fiduciaries because they are exercising powers traditionally held by fiduciaries or because they can effectively exercise control over the fiduciaries.

Substantial decisions are those decisions that persons are authorized or required to make under the terms of the trust instrument and applicable law and that are not ministerial. Included in the proposed regulations is a nonexclusive list of substantial decisions. Substantial decisions do not include decisions exercisable by a grantor that is not a fiduciary of the trust, or decisions exercisable by a beneficiary that affect only the beneficiary's interest in the trust.

In accordance with the legislative history, the proposed regulations provide that United States fiduciaries have the authority to control all substantial decisions of the trust when they have the power by vote or otherwise to make all of the substantial decisions of the trust and no foreign fiduciary has the power to veto the substantial decisions of the United States fiduciaries.

The proposed regulations contain rules addressing automatic migration clauses, also known as "flee clauses." The proposed regulations provide that the control test is not met if an attempt by any governmental agency or creditor to collect information from or assert a claim against the trust would cause one or more substantial decisions of the trust to no longer be controlled by United States fiduciaries.

The proposed regulations are proposed to apply to trusts for taxable years beginning after December 31, 1996, and to a trust whose trustee has elected to apply sections 7701(a)(30) and (31) to the trust for taxable years ending after August 20, 1996, under section 1907(a)(3)(B) of the Act. Notice 96-65

(1996-52 I.R.B. 28) grants trusts that meet the conditions specified in that notice additional time to comply with the new domestic trust criteria contained in the Act and allows such trusts to continue to file as domestic trusts during the period specified in that notice. Notice 96-65 also addresses the time and manner for making the election provided by the Act to apply the new domestic trust criteria retroactively for taxable years of the trust ending after August 20, 1996. Notice 96-65 remains in effect and should be consulted for these purposes.

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking 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 regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### *Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 16, 1997, at 10 a.m. in the Internal Revenue Service Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by August 4, 1997, and submit an outline of the topics to be discussed and the time to be devoted to

each topic (preferably a signed original and eight (8) copies) by August 26, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

The principal authors of these regulations are James A. Quinn and Eliana Dolgoff of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

#### PART

#### 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

#### § 301.7701–5 [Amended]

Par. 2. The last sentence of section 301.7701–5 is removed.

Par. 3. Section 301.7701–7 is added to read as follows:

#### § 301.7701–7 Trusts—domestic and foreign.

(a) *In general.* (1) A trust is a United States person if—

(i) A court within the United States is able to exercise primary supervision over the administration of the trust (court test); and

(ii) One or more United States fiduciaries have the authority to control all substantial decisions of the trust (control test).

(2) A trust is a United States person for purposes of the Internal Revenue Code at any time that the trust meets both the court test and the control test. For purposes of the regulations in this chapter, the term *domestic trust* means a trust that is a United States person. The

term *foreign trust* means any trust other than a domestic trust.

(3) Except as otherwise provided in part I, subchapter J, chapter 1 of the Code, the taxable income of a foreign trust is computed in the same manner as the taxable income of a nonresident alien. Thus, section 7701(b) does not apply to determine whether a foreign trust is a resident alien. In addition, a foreign trust is not considered to be present in the United States for purposes of section 871(a)(2).

(b) *Applicable law.* The terms of the trust instrument and applicable law must be applied to determine whether the court test and the control test are met.

(c) *In general.*—(1) *Safe harbor.* A trust is a domestic trust if the trust has only United States fiduciaries, as defined in paragraph (e) of this section, the trust is administered exclusively in the United States pursuant to the terms of a trust instrument, and the trust is not subject to an automatic migration provision described in paragraph (d)(2)(v) or (e)(3) of this section.

(2) *Example.* The following example illustrates the rule of paragraph (c)(1) of this section:

*Example.* A executes a trust instrument for the equal benefit of A's two children, B and C. The trust instrument provides that DC, a State Y corporation, is the only trustee of the trust. Pursuant to the terms of the trust instrument, the trust is administered in State Y, a state within the United States. The trust is not subject to an automatic migration provision described in paragraph (d)(2)(v) or (e)(3) of this section. No person other than DC has any power over the trust. The trust satisfies the safe harbor of paragraph (c)(1) and is a domestic trust.

(d) *The court test.*—(1) *Definitions.* The following definitions apply for purposes of the court test:

(i) *Court.* The term *court* includes any federal, state, or local court.

(ii) *The United States.* The term *the United States* is used in this section in a geographical sense. Thus, for purposes of the court test, the United States includes only the States and the District of Columbia. See section 7701(a)(9). Accordingly, a court within a territory or possession of the United States or within a foreign country is not a court within the United States.

(iii) *Is able to exercise.* The term *is able to exercise* means that a court has or would have the authority under applicable law to render orders or judgments resolving issues concerning administration of the trust.

(iv) *Primary supervision.* The term *primary supervision* means that a court has or would have the authority to determine substantially all issues regarding the administration of the entire trust. A court may have primary supervision even if another court has jurisdiction over a trustee, a beneficiary, or trust property.

(v) *Administration.* The term *administration* of the trust means the carrying out of the duties imposed on a fiduciary by the terms of the trust instrument and applicable law, including maintaining the books and records of the trust, filing tax returns, defending the trust from suits by creditors, and determining the amount and timing of distributions.

(2) *Situations that meet the court test.*—(i) *Uniform Probate Code.* A trust meets the court test if a trust is registered by an authorized fiduciary in a court within the United States under a state statute that has provisions substantially similar to Article VII, *Trust Administration*, of the Uniform Probate Code, 8 Uniform Laws Annotated 1 (West Supp. 1997), available from the National Conference of Commissioners on Uniform State Laws, 676 North St. Clair Street, Suite 1700, Chicago, Illinois 60611.

(ii) *Testamentary trust.* In the case of a trust created pursuant to the terms of a will probated within the United States (other than an ancillary probate), if all fiduciaries of the trust have been qualified as trustees of the trust by a court within the United States, the trust meets the court test.

(iii) *Inter vivos trust.* In the case of a trust other than a testamentary trust, if the fiduciaries and/or beneficiaries take steps with a court within the United States that cause the administration of the trust to be subject to the primary supervision of the court, the trust meets the court test.

(iv) *A United States and a foreign court are able to exercise primary supervision over the administration of the trust.* If both a United States court and a foreign court are able to exercise primary supervision over the administration of the trust, the trust meets the court test.

(v) *Automatic migration provisions.* Notwithstanding any other provision in this section, a court within the United States is not considered to have primary supervision over the administration of the trust if the trust instrument provides that a United States court's attempt to assert jurisdiction or otherwise supervise

the administration of the trust directly or indirectly would cause the trust to migrate from the United States.

(3) *Examples.* The following examples illustrate the rules of this paragraph (d):

*Example 1.* A, a United States citizen, executes a trust instrument for the equal benefit of A's two United States children. The trust instrument provides that *DC*, a domestic corporation, is to act as trustee of the trust and that the trust is to be administered in Country *X*, a foreign country. The trust instrument provides that the law of State *Y*, a state within the United States, is to govern the trust. Under the law of Country *X*, a court within Country *X* is able to exercise primary supervision over the administration of the trust but, as required by the trust instrument, applies the law of State *Y* to the trust. No court within the United States is able to exercise primary supervision over the administration of the trust. The trust fails to satisfy the court test and therefore is a foreign trust.

*Example 2.* Trust *T* owns a single asset, an interest in land located in State *Y*, a state within the United States. Under the law of State *Y*, a trust owning solely real property within the state is subject to the primary supervision over the administration of the trust by a court within State *Y*. The trust satisfies the court test.

*Example 3.* A, a United States citizen, executes a trust instrument for his own benefit and the benefit of *B*, his United States spouse. The trust instrument provides that the trust is to be administered in State *Y*, a state within the United States, by *DC*, a State *Y* corporation. The trust instrument further provides that in the event that a creditor sues the trustee in a United States court, the trust will migrate from State *Y* to Country *Z*, a foreign jurisdiction, so that no United States court will have jurisdiction over the trust. A court within the United States is not able to exercise primary supervision over the administration of the trust because the United States court's jurisdiction over the administration of the trust is automatically terminated in the event the court attempts to assert jurisdiction. Therefore, the trust fails to satisfy the court test from the time of its creation and is a foreign trust.

(e) *Control test—(1) Definitions—(i) United States fiduciary.* The term *fiduciary* includes any person described in section 7701(a)(6) and § 301.7701–6(b). In addition, for purposes of this section, any other person who has the power to control one or more substantial decisions of the trust (and therefore has a power ordinarily held by a fiduciary) will be treated as a fiduciary. A person may be treated as a fiduciary even if the trust instrument provides for the person to be relieved of personal liability for violation of duties. A United States fiduciary is a fiduciary that is a United States person within the meaning of section 7701(a)(30). For example, a fiduciary which is a United States corporation owned by a nonresident alien is a United States fiduciary.

(ii) *Substantial decisions.* (A) The term *substantial decisions* means those decisions (other than those described in

paragraph (e)(1)(ii)(B) of this section) that persons are authorized or required to make under the terms of the trust instrument and applicable law and that are not ministerial. Substantial decisions include, but are not limited to—

- (1) Whether and when to distribute income or corpus;
- (2) The amount of any distributions;
- (3) The selection of a beneficiary;
- (4) The power to make investment decisions;
- (5) Whether a receipt is allocable to income or principal;
- (6) Whether to terminate the trust;
- (7) Whether to compromise, arbitrate, or abandon claims of the trust;
- (8) Whether to sue on behalf of the trust or to defend suits against the trust; and
- (9) Whether to remove, add, or replace a trustee.

(B) Substantial decisions do not include decisions exercisable by a grantor, unless the grantor is acting as a fiduciary under section 7701(a)(6) and § 301.7701–6(b). In addition, substantial decisions do not include decisions exercisable by a beneficiary, unless the beneficiary is acting as a fiduciary under section 7701(a)(6) and § 301.7701–6(b), that affect solely the portion of the trust in which the beneficiary has an interest. Decisions that are ministerial include decisions regarding details such as the bookkeeping, the collection of rents, and the execution of investment decisions made by the fiduciaries.

(iii) *Control.* Control means having the power, by vote or otherwise, to make all of the substantial decisions of the trust, with no other person having the power to veto the substantial decisions. However, the ability of a grantor (other than a grantor acting as a fiduciary under section 7701(a)(6) and § 301.7701–6(b)) to veto another person's substantial decision does not cause such person to fail to control that substantial decision. In addition, the ability of a beneficiary (other than a beneficiary acting as a fiduciary under section 7701(a)(6) and § 301.7701–6(b)) to veto another person's substantial decision that affects solely the portion of the trust in which the beneficiary has an interest does not cause such person to fail to control that substantial decision.

(2) *Replacement of a fiduciary.* In the event of an inadvertent change in the fiduciaries that would cause a change in the residency of a trust, the trust is allowed six months from the date of the change in the fiduciaries to adjust either

the fiduciaries or the residence of the fiduciaries so as to avoid a change in the residence of the trust. Inadvertent changes in the fiduciaries include the death of a fiduciary or the abrupt resignation of a fiduciary. If the adjustment is made within six months, the trust is treated as retaining its pre-change residence during the six-month period. If the adjustment is not made within six months, the trust residence changes as of the date of the inadvertent change.

(3) *Automatic migration provisions.* Notwithstanding any other provision in this section, United States fiduciaries are not considered to control all substantial decisions of the trust if an attempt by any governmental agency or creditor to collect information from or assert a claim against the trust would cause one or more substantial decisions of the trust to no longer be controlled by United States fiduciaries.

(4) *Examples.* The following examples illustrate the rules of this paragraph (e):

*Example 1.* *A* is a nonresident alien individual. *A* is the grantor and beneficiary of an individual retirement account (IRA) and has the exclusive power to make decisions regarding withdrawals from the IRA and to direct its investments. *A* is not a fiduciary as defined in paragraph (e)(1)(i) of this section. The IRA has a single United States trustee and no foreign trustees. The United States trustee has the power to control all decisions of the trust other than withdrawal and investment decisions. In this case, decisions regarding withdrawals and the trust's investments are not substantial decisions because these decisions are solely exercisable by the grantor. Therefore, the control test is satisfied because the United States fiduciary controls all substantial decisions.

*Example 2.* *A* is a nonresident alien individual. *A* is the grantor of a trust and has the power to revoke the trust, in whole or in part and revest assets in *A*. *A* is the owner of the trust under section 676. *A* is not a fiduciary as defined in paragraph (e)(1)(i) of this section. The trust has two trustees, *B*, a United States person and *C*, a nonresident alien. *C*'s only power is the power to make distributions from the trust and *C* can exercise this power without authorization from *B*. In this case, decisions exercisable by *A* to have trust assets distributed to *A* are not substantial decisions because these decisions are exercisable by the grantor. However, distribution decisions exercisable by *C* are substantial decisions. Therefore, the trust is a foreign trust because *B* does not control all substantial decisions of the trust.

*Example 3.* Trust has three fiduciaries, *A*, *B*, and *C*. *A* and *B* are United States citizens and *C* is a nonresident alien. The trust instrument directs that *C* is to make all of the trust's investment decisions, but that *A* and *B* may veto *C*'s investment decisions. *A* and *B* cannot act to make the investment decisions on their own. The control test is not satisfied because the United States fiduciaries, *A* and *B*, do not have the power to make all of the substantial decisions of the trust.

*Example 4.* Trust has two fiduciaries, *A* and *B*, both of whom are United States citizens. The trust instrument provides that *C*, a foreign corporation,

will serve as an advisor and recommend investments to *A* and *B*. *A* and *B* may accept or reject *C*'s recommendations and can make investments that *C* has not recommended. *A* and *B* control all other decisions of the trust. *A* and *B* delegate to *C* the authority to execute the investment decisions approved by *A* and *B*. The control test is satisfied because the United States fiduciaries control all substantial decisions of the trust.

*Example 5.* Trust has three fiduciaries, *A*, *B*, and *C*. *A* and *B* are United States citizens and *C* is a nonresident alien. The trust instrument provides that no substantial decisions of the trust can be made unless there is unanimity among the fiduciaries. The control test is not satisfied because the United States fiduciaries do not control all the substantial decisions of the trust. No substantial decisions can be made without *C*'s agreement.

*Example 6.* (i) A trust that satisfies the court test has three fiduciaries, *A*, *B*, and *C*. *A* and *B* are United States citizens and *C* is a nonresident alien. Decisions are made by majority vote of the fiduciaries. The trust instrument provides that upon the death or resignation of any of the fiduciaries, *D*, a nonresident alien, is the successor fiduciary. *A* dies and *D* becomes a fiduciary of the trust. Two months after *A* dies, *E*, a United States person, replaces *D* as a fiduciary of the trust. During the period after *A*'s death and before *E* begins to serve, the trust satisfies the control test and remains a domestic trust.

(ii) Assume the same facts as in paragraph (i) of this *Example 6* except that at the end of the six-month period after *A*'s death, *D* has not been replaced and remains a fiduciary of the trust. The trust became a foreign trust on the date *A* died.

*Example 7.* Trust has three beneficiaries, *A*, *B* and *C*, all of whom are nonresident aliens. Each beneficiary has the right to receive all of the income from his or her share of the trust for life. Each beneficiary also has a limited power of appointment over his or her respective share of the trust. The trust has only one fiduciary, *D*, a United States citizen. The trust meets the control test because the United States fiduciary controls all substantial decisions of the trust notwithstanding the beneficiaries' powers of appointment over their respective interests.

(f) *Effective date.* This section is applicable to trusts for taxable years beginning after December 31, 1996, and to trusts whose trustee has elected to apply sections 7701(a)(30) and (31) to the trust for taxable years ending after August 20, 1996, under section 1907(a)(3)(B) of the Small Business Job Protection Act of 1996, Public Law 104–188, 110 Stat. 1755 (26 U.S.C. 7701 note).

Michael P. Dolan,  
Acting Commissioner of Internal  
Revenue.

(Filed by the Office of the Federal Register on June 4, 1997, 8:45 a.m., and published in the issue of the Federal Register for June 5, 1997, 62 F.R. 30796)

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Inbound Grantor Trusts With Foreign Grantors

#### REG-252487-96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations implementing section 672(f) of the Internal Revenue Code, as amended by the Small Business Job Protection Act of 1996, which relates to the application of the grantor trust rules to certain trusts established by foreign persons. The proposed regulations affect primarily United States persons who are beneficiaries of trusts established by foreign persons. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by August 4, 1997. Requests to speak (with outlines of oral comments) to be discussed at the public hearing scheduled for August 27, 1997, at 10 a.m. must be submitted by August 6, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-252487-96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-252487-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The public hearing will be held in room 3313, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning § 1.671–2(e), James Quinn (202) 622–3060; concerning the remainder of these regulations, M. Grace Fleeman (202) 622–3850; concerning submissions and the hearing, Michael Slaughter (202) 622–7190 (not toll-free numbers).

## SUPPLEMENTARY INFORMATION

### Background

Section 1904 of the Small Business Job Protection Act of 1996 (the Act), Public Law 104–188, 110 Stat. 1755 (August 20, 1996), amended section 672(f) and certain other sections of the Internal Revenue Code (Code). The amendments affect the application of sections 671 through 679 of the Code (the grantor trust rules) to certain trusts created by foreign persons.

#### 1. Prior law

Under prior law, a grantor of a trust generally was treated as the owner of any portion of the trust over which he retained any of the powers or interests described in sections 673 through 677 without regard to whether he was a domestic or foreign person. A special rule contained in prior section 672(f) generally provided that, if a U.S. beneficiary of a trust created by a foreign person transferred property to the foreign person by gift, the U.S. beneficiary was treated as the grantor of the trust to the extent of the transfer.

Under the prior rules, if a foreign person created a trust with one or more U.S. beneficiaries that was treated as a grantor trust with the foreign person as the grantor, a distribution of income from the trust to a U.S. beneficiary was treated as a gift and was not subject to U.S. income tax in the hands of the beneficiary. See Rev. Rul. 69–70 (1969–1 C.B. 182). If the income of the trust was not taxable to the foreign grantor under section 871 and also not taxable to either the grantor or the trust by either the grantor's country of residence or another foreign country, the income of the trust was, thus, not subject to tax by any jurisdiction.

A special rule contained in section 665(c) provided generally that intermediaries or nominees interposed between certain foreign trusts and their U.S. beneficiaries could be disregarded. However, that rule applied only to trusts created by U.S. persons.

#### 2. Overview of changes

The changes made by section 1904 of the Act are designed to ensure that U.S. persons who benefit from offshore trusts created by foreign persons (inbound trusts) pay an appropriate amount of U.S. tax. Generally, the grantor trust rules now cause a person to be treated as the owner of a trust only to the

extent such application results, directly or indirectly, in an amount being currently taken into account in computing the income of a U.S. citizen or resident or a domestic corporation. Exceptions are provided for certain revocable trusts, for trusts from which the only amounts distributable during the lifetime of the grantor are to the grantor or the grantor's spouse, and for certain compensatory trusts. There also are grandfather rules for certain trusts that were in existence on September 19, 1995.

As a result of the changes, many inbound trusts that were grantor trusts under prior law are now nongrantor trusts. Distributions of trust income to the U.S. beneficiaries of such trusts are now taxable to U.S. beneficiaries and may be subject to an interest charge on accumulation distributions.

Section 1904 of the Act also includes some special rules. Section 643(h), which replaces former section 665(c), treats any amount paid to a U.S. person that is derived directly or indirectly from a foreign trust of which the payor is not the grantor as if the amount is paid by the foreign trust directly to the U.S. person. Section 672(f)(4) allows the IRS to recharacterize a purported gift or bequest from a partnership or foreign corporation when necessary to prevent the avoidance of the purpose of section 672(f). Section 672(f)(5), which is an expansion of prior section 672(f), generally provides that if a U.S. beneficiary of a trust created by a foreign person transfers property to the foreign person, the U.S. beneficiary is treated as the grantor of the trust to the extent of the transfer.

#### *Explanation of Provisions*

##### *1. § 1.643(h)-1: Distributions by certain foreign trusts through intermediaries*

The proposed regulations describe the circumstances under which an amount of property that is derived, directly or indirectly, by a U.S. person from a foreign trust through an intermediary will be deemed to have been paid directly by the foreign trust to the U.S. person. This rule does not apply if the intermediary is the grantor of the portion of the trust from which the amount is distributed. The amount will be deemed to have been paid directly by the foreign trust if any one of the following conditions is satisfied: (1) the intermediary is related (as defined in the regulations) to either the U.S. person or

the foreign trust and the intermediary transfers to the U.S. person either property that the intermediary received from the trust or proceeds from the property that the intermediary received from the trust; (2) the intermediary would not have transferred the property to the U.S. person (or would not have transferred the property on substantially the same terms) but for the fact the intermediary received property from the foreign trust; or (3) the intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax.

The proposed regulations describe the effect of disregarding the intermediary. If the intermediary is an agent of either the foreign trust or the U.S. person under generally applicable agency principles (under the standards set forth in *Commissioner v. Bollinger*, 485 U.S. 340 (1988)), the amount is treated as paid by the foreign trust to the U.S. person in the year it would be so treated under the general principles. Thus, if the intermediary is an agent of the foreign trust, the amount is treated as paid to the U.S. person in the year it is paid by the intermediary to the U.S. person. If, however, the intermediary is an agent of the U.S. person, the amount is treated as paid to the U.S. person in the year it is paid by the foreign trust to the intermediary.

If the intermediary is not an agent of either the foreign trust or the U.S. person under generally applicable agency principles, the intermediary generally will be treated as an agent of the foreign trust, and the amount will be treated as paid by the foreign trust to the U.S. person in the year the amount is paid by the intermediary to the U.S. person. However, the district director may determine, based on all the relevant facts and circumstances, that the intermediary should be treated as the agent of the U.S. person.

The regulations provide a de minimis rule for distributions that do not exceed in the aggregate \$10,000.

##### *2. § 1.671-2(e): Definition of grantor*

The proposed regulations provide a definition of grantor that applies for purposes of the grantor trust rules generally. A grantor is any individual, corporation, or other person to the extent such person (i) creates a trust or (ii) directly or indirectly makes a gratuitous transfer to a trust. For purposes of the proposed regulations, a gratuitous transfer is any

transfer other than a transfer for fair market value, or a corporate or partnership distribution. Treasury and the IRS request comments regarding the appropriate scope of gratuitous transfers.

A grantor includes a person who acquires an interest in a trust in a nongratuitous transfer from a person who is a grantor of the trust. A grantor also includes an investor who acquires an interest in a fixed investment trust from a person who had acquired his interest through a direct investment in the trust. Treasury and the IRS request comments on the appropriate scope of these rules as they affect fixed investment trusts.

If a person creates or funds any portion of a trust primarily as an accommodation for another person, the other person will be treated as a grantor with respect to such portion of the trust. See, e.g., *Stern v. Commissioner*, 77 T.C. 614 (1981), rev'd on other grounds, 747 F.2d 555 (9th Cir. 1984).

These regulations are not intended to change the result of existing law with respect to trusts used for business purposes. See § 301.7701-4(e) (environmental remediation trusts); Rev. Rul. 87-127, 1987-2 C.B. 156 (pre-need funeral trusts); Rev. Proc. 92-64, 1992-2 C.B. 422 (rabbi trusts). Treasury and the IRS request comments on the application of these new rules to trusts used for business purposes.

A grantor of a trust may or may not be treated as an owner of the trust under sections 671 through 677 and 679. A person other than a grantor of a trust may be treated as an owner of the trust under section 678.

##### *3. § 1.672(f)-1: Foreign persons not treated as owners*

The proposed regulations prescribe a two-step analysis for implementing the general rule of section 672(f). First, the grantor trust rules other than section 672(f) (the basic grantor trust rules) are applied to determine the worldwide amount and the U.S. amount. Then, the trust is treated as partially or wholly owned by a foreign person based on an annual year-end comparison of the worldwide amount and the U.S. amount.

The worldwide amount is defined as the net amount of income, gains, deductions, and losses that would be taken into account for the current year under the basic grantor trust rules in computing the worldwide taxable income of any person, whether or not such person

is a U.S. taxpayer (as defined in the regulation). The worldwide amount is determined in accordance with U.S. principles of income taxation, and includes amounts that would be attributable to foreign persons, without regard to whether such amounts are subject to U.S. income taxation.

The U.S. amount is defined as the net amount of income, gains, deductions, and losses that would be taken into account for the current year under the basic grantor trust rules (directly or through one or more entities) in computing the taxable income of a U.S. taxpayer. The U.S. amount includes amounts such as interest on state or local bonds that are not includable in gross income.

A U.S. taxpayer is defined as any person who is a U.S. citizen, a resident alien individual, a domestic corporation, a U.S. person who is treated as the owner of a trust under section 679, or a domestic trust to the extent such trust actually pays U.S. tax with respect to the income, gains, deductions, and losses.

If the worldwide amount and the U.S. amount are the same, the basic grantor trust rules continue to apply without the limitation of section 672(f). If the worldwide amount is greater than the U.S. amount, section 672(f) prevents the basic grantor trust rules from treating a person as the owner of that portion of the trust attributable to the excess of the worldwide amount over the U.S. amount.

#### *4. § 1.672(f)-2: Trusts created by certain foreign corporations*

Section 672(f)(3) provides in part that, except as otherwise provided in regulations, a controlled foreign corporation (CFC) shall be treated as a domestic corporation for purposes of section 672(f)(1). Under the proposed regulations, a CFC that creates and funds a trust will be treated as a domestic corporation to the extent that, if the basic grantor trust rules were applied, income earned by the trust for the taxable year would be subpart F income to the CFC that would be currently taken into account in computing the gross income of a U.S. citizen or resident or a domestic corporation. However, the CFC will not be treated as a domestic corporation to the extent the income of the trust would not be subpart F income or to the extent it would be subpart F income but would not be

taken into account in computing the gross income of a U.S. citizen or resident or a domestic corporation (e.g., the CFC had no overall earnings and profits).

The proposed regulations include similar rules for trusts created by passive foreign investment companies (PFICs) or foreign personal holding companies.

Section 672(f)(3) also provides that the general rule of section 672(f)(1) shall not apply for purposes of section 1296. The proposed regulations implement this rule by providing that, for purposes of determining whether a foreign corporation is a PFIC, the grantor trust rules shall be applied as if section 672(f) had not come into effect. Consequently, a foreign corporation cannot avoid PFIC status by transferring passive assets to a trust that would be treated as a nongrantor trust if section 672(f) were applied.

#### *5. § 1.672(f)-3: Exceptions to general rule*

##### **A. Certain revocable trusts**

The proposed regulations provide that the general rule of § 1.672(f)-1 does not apply to any portion of a trust if the power to vest in the grantor title to such portion is exercisable solely by the grantor without the approval or consent of any other person. If the grantor can exercise the power only with the approval of a related or subordinate party who is subservient to the grantor, such power will be treated as exercisable solely by the grantor.

The exception will not apply unless the power to vest is exercisable for a period or periods aggregating 183 days or more during the taxable year of the trust. This rule is intended to provide a bright line rule for the benefit of both taxpayers and IRS examiners that addresses potentially abusive situations in which a power to vest is so limited that it is not likely to be exercised. The 183 days need not be consecutive; thus, a power to vest that is exercisable each year from January 1 through May 31 and again from September 1 through December 31 would be eligible for the exception.

Consistent with the statute, the proposed regulations provide a grandfather rule for a trust that was treated as owned by the grantor under section 676 on September 19, 1995. As long as such a trust would continue to be so treated under the basic grantor trust rules, the

trust will be exempt from the general rule of section 672(f), except with respect to any portion of the trust attributable to transfers to the trust after September 19, 1995. Under the proposed regulations, separate accounting is required for amounts transferred to the trust after September 19, 1995, together with all income and gains thereof, as well as losses and distributions therefrom.

##### **B. Certain other trusts**

The proposed regulations provide that the general rule does not apply to any trust (or portion of a trust) if the only amounts distributable (whether income or corpus) from such trust (or portion of a trust) during the lifetime of the grantor are amounts distributable to the grantor or the grantor's spouse. For this purpose, payments of reasonable nongratuitous amounts, such as reasonable administrative expenses, are not considered to be amounts distributable from the trust.

The proposed regulations clarify that amounts distributable in discharge of a legal obligation of the grantor or the grantor's spouse will generally be treated as amounts distributable to the grantor or the grantor's spouse. Thus, it is expected that a reinsurance trust that would have been a grantor trust under prior law generally will continue to be a grantor trust. (No inference is intended as to whether a reinsurance trust constitutes a trust under regulation § 301.7701-4.) However, a legal obligation will not include an obligation to a person who is related (as defined in the regulations) to the grantor or the grantor's spouse, unless the obligation was entered into for adequate and full consideration in money or money's worth. Trusts from which distributions are taxable as compensation for services rendered generally will be covered by the exception for compensatory trusts, described below.

Amounts distributable to support a family member will be treated as amounts distributable to the grantor or the grantor's spouse only if certain requirements are satisfied. Although different jurisdictions have different requirements for support obligations, administrative simplicity is served by providing one uniform rule on this point. Under the proposed regulations, the family member must be an individual who would be treated as a dependent of the grantor or the grantor's

spouse under sections 152(a)(1) through (8), without regard to the requirement that half of the individual's support be received from the grantor or the grantor's spouse. In addition, the family member must be either permanently and totally disabled (within the meaning of section 22(e)(3)) or, in the case of a son, daughter, stepson, or stepdaughter, less than 24 years old.

Consistent with the statute, the proposed regulations provide a grandfather rule for a trust that was treated as owned by the grantor under section 677 (other than subsection (a)(3) thereof) on September 19, 1995. As long as such a trust would continue to be so treated under the basic grantor trust rules, the trust will be exempt from the general rule, except with respect to any portion of the trust attributable to transfers to the trust after September 19, 1995. Under the proposed regulations, separate accounting is required for amounts transferred to the trust after September 19, 1995, together with all income and gains thereof, as well as losses and distributions therefrom.

#### C. Compensatory trusts

The proposed regulations implement section 672(f)(2)(B), which provides that, except as provided in regulations, the general rule shall not apply to any portion of a trust from which distributions are taxable as compensation for services rendered. Tracking the language of the statute, the proposed regulations list categories of trusts that constitute compensatory trusts, without regard to whether they could be treated as grantor trusts under the basic grantor trust rules. This list is intended to be an exclusive list. However, the proposed regulations also provide that additional categories of compensatory trusts may be designated later in guidance published in the Internal Revenue Bulletin.

The following categories of trusts are classified as compensatory trusts: (i) qualified trusts described in section 401(a), (ii) trusts described in section 457(g), (iii) nonexempt employees' trusts described in section 402(b), (iv) individual retirement account (IRA) trusts that are either simplified employee pensions described in section 408(k) or simple retirement accounts described in section 408(p), (v) IRA trusts to which the only contributions are rollover contributions listed in section 408(a)(1), (vi) certain so-called rabbi trusts (see Rev. Proc. 92-64 (1992-2 C.B. 422)), and

(vii) trusts that are welfare benefit funds described in section 419(e) (without regard to whether they provide taxable benefits).

The IRS and Treasury contemplate that the nonexempt employees' trusts listed in category (iii) above will be treated as grantor trusts only to the extent provided in proposed regulations § 1.671-1(g) and § 1.671-1(h), which were published in the **Federal Register** (61 FR 50778) on September 27, 1996.

IRAs that are excluded from the list of compensatory trusts because they are funded by individuals, rather than employers, are expected to be covered by one or both of the exceptions for revocable trusts or for trusts from which the only amounts distributable during the lifetime of the grantor are to the grantor or the grantor's spouse.

#### 6. § 1.672(f)-4: Recharacterization of purported gifts

The proposed regulations implement the purported gift rule of section 672(f)(4), which was enacted as a backstop to section 672(f). See Staff of the Joint Committee on Taxation, 104th Cong., 2nd Sess., General Explanation of the Tax Legislation Enacted in the 104th Congress, at 271 (1996). The purported gift rule prevents taxpayers from avoiding the general rule of section 672(f) by using a partnership or a foreign corporation as a substitute for a trust.

As a general rule, if a U.S. donee receives a purported gift or bequest directly or indirectly from a partnership, the purported gift or bequest must be included in the U.S. donee's income as ordinary income. If a U.S. donee receives a purported gift or bequest directly or indirectly from a foreign corporation, the purported gift or bequest generally must be included in the U.S. donee's gross income as a distribution from the foreign corporation. In the latter case, the U.S. donee will not be treated as having basis in the foreign corporation, and the U.S. donee will be treated as having a holding period in the foreign corporation equal to the average holding period (using a weighted average) of the actual interest holders.

However, the gift or bequest will not be recharacterized if the donee can establish that a U.S. citizen or resident alien who directly or indirectly holds an interest in the partnership or foreign corporation treated the purported gift as a distribution from the partnership or

foreign corporation and a subsequent gift to the donee. There also is an exception for charitable contributions to donees described in section 170(c).

The proposed regulations provide rules for gratuitous transfers to U.S. donees from trusts created by partnerships or foreign corporations. As a result, a partnership or foreign corporation cannot avoid the purported gift rule by creating a nongrantor trust that makes an immediate nontaxable distribution of trust corpus to a U.S. donee. Under the proposed regulations, if the partnership or foreign corporation is not treated under the grantor trust rules as the owner of the portion of the trust from which property is distributed to a U.S. donee in a gratuitous transfer, the distribution will be characterized as a distribution from the partnership or foreign corporation if such characterization results in a higher U.S. tax liability.

Notwithstanding any other provision, the proposed regulations provide that the district director may recharacterize a transfer that is subject to the rules of section 672(f)(4) to prevent the avoidance of U.S. tax or clearly to reflect income. For example, the district director may determine, based upon the facts and circumstances, that a distribution from a partnership or foreign corporation is more properly treated as a distribution from a trust.

The proposed regulations provide a de minimis rule for purported gifts or bequests that do not exceed in the aggregate \$10,000.

#### 7. § 1.672(f)-5: Special rules

##### A. Transfers by certain beneficiaries to foreign settlor

The proposed regulations provide that if, but for section 672(f)(5), a foreign person would be treated as the owner of any portion of a trust, any U.S. beneficiary of the trust will be treated as the owner of a portion of the trust to the extent the U.S. beneficiary directly or indirectly made transfers of property to such foreign person in excess of transfers to the U.S. beneficiary from the foreign person. (Such a transfer may also constitute an indirect transfer from a U.S. person to a foreign trust for purposes of section 679.) The U.S. beneficiary need not have been a U.S. person at the time of the transfer.

The proposed regulations do not specify a time period within which a transfer must have been made to trigger this rule. However, they do provide that

the rule will not apply to the extent the U.S. beneficiary can demonstrate that the transfer was wholly unrelated to any transaction involving the trust. In addition, consistent with the statute, the proposed regulations provide that a transfer of property does not include either a nongratuitous transfer or a gift that would be excluded from taxable gifts under section 2503(b).

#### B. Different taxable years

The proposed regulations provide that if a person has a different taxable year from the taxable year of the trust, an amount is currently taken into account in computing the income of such person for purposes of the general rule if the amount is taken into account for the taxable year of such person that includes the last day of the taxable year of the trust.

#### C. Entity characterization

The proposed regulations provide that entities generally will be characterized under U.S. income tax principles. See regulations §§ 301.7701–1 through 301.7701–4. However, an entity having a single owner could avoid the purported gift rule if it could elect to be disregarded as a separate entity, because the purported gift or bequest would then be received from the owner of the entity, rather than from the entity itself. Therefore, the proposed regulations provide that, for purposes of section 672(f)(4), a wholly owned business entity must be treated as a corporation, separate from its single owner.

#### 8. § 301.7701–2(c)(2)(iii): Special rule for business entities that make purported gifts

As explained above, an entity having a single owner could avoid the purported gift rule if it elected to be disregarded as a separate entity under the existing entity classification regulations. Therefore, the proposed regulations add a new sentence to the existing regulations to provide that, for purposes of section 672(f)(4), a wholly owned business entity must be treated as a corporation, separate from its owner.

#### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 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. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for August 27, 1997, at 10 a.m., in room 3313, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by August 4, 1997, and submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by August 6, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### Drafting Information

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

\* \* \* \* \*

#### Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be 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 as follows:

Authority: 26 U.S.C. 7805 \* \* \*  
Section 1.643(h)–1 also issued under 26 U.S.C. 643(a)(7).

Section 1.671–2(e) also issued under 26 U.S.C. 643(a)(7) and 672(f)(6).  
Section 1.672(f)–1 also issued under 26 U.S.C. 643(a)(7) and 672(f)(6).

Section 1.672(f)–2 also issued under 26 U.S.C. 643(a)(7), 672(f)(3) and (6).  
Section 1.672(f)–3 also issued under 26 U.S.C. 643(a)(7), 672(f)(2) and (6).

Section 1.672(f)–4 also issued under 26 U.S.C. 643(a)(7), 672(f)(4) and (6).  
Section 1.672(f)–5 also issued under 26 U.S.C. 643(a)(7) and 672(f)(6). \* \* \*

Par. 2. Section 1.643(h)–1 is added to read as follows: § 1.643(h)–1 Distributions by certain foreign trusts through intermediaries.

(a) *In general.* For purposes of sections 641 through 683, any amount of property that is derived, directly or indirectly, by a United States person from a foreign trust through another person (an intermediary) shall be deemed to have been paid directly by the foreign trust to the United States person if any one of the following conditions is satisfied—

(1) The intermediary is related (within the meaning of paragraph (e) of this section) to either the United States person or the foreign trust and the intermediary transfers to the United States person either property that the intermediary received from the foreign trust or proceeds from the property that the intermediary received from the foreign trust;

(2) The intermediary would not have transferred the property to the United States person (or would not have transferred the property to the United States person on substantially the same terms) but for the fact that the intermediary received property from the foreign trust; or

(3) The intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax.

(b) *Exception for grantor as intermediary.* Paragraph (a) of this section shall not apply if the intermediary is the grantor of the portion of the trust from which the amount is derived. For the definition of grantor, see § 1.671–2(e).

(c) *Effect of disregarding intermediary.* If an amount is treated as paid

directly by the foreign trust to a United States person pursuant to this section, one of the following rules shall apply:

(1) *Intermediary is agent under general principles.* If the intermediary is an agent of the foreign trust or the United States person under generally applicable agency principles, the payment shall be treated as paid by the foreign trust to the United States person in the year it would be so treated under such principles. Thus, if the intermediary is an agent of the foreign trust, the payment shall be treated as paid to the United States person in the year the amount is paid by the intermediary to the United States person. If, however, the intermediary is an agent of the United States person, the payment shall be treated as paid to the United States person in the year the amount is paid by the foreign trust to the intermediary.

(2) *Intermediary is not agent under general principles—(i) Agent of foreign trust.* Except as provided in paragraph (c)(2)(ii) of this section, if the intermediary is not an agent of the foreign trust or the United States person under generally applicable agency principles—

(A) The intermediary shall be treated as an agent of the foreign trust; and

(B) The payment shall be treated as paid by the foreign trust to the United States person in the year the amount is paid by the intermediary to the United States person.

(ii) *Agent of United States person.* The district director may determine, based on all the relevant facts and circumstances, that the intermediary should be treated as the agent of the United States person. If the intermediary is treated as the agent of the United States person pursuant to this paragraph (c)(2)(ii), the payment shall be treated as paid to the United States person in the year the intermediary receives the payment from the foreign trust.

(d) *De minimis exception.* This section shall not apply if, during the taxable year of the United States person, the aggregate amount that is transferred to such person from all foreign trusts through one or more intermediaries does not exceed \$10,000.

(e) *Related parties.* For purposes of this section, an intermediary shall be treated as related to a United States person or foreign trust if the intermediary and the United States person or foreign trust are related within the meaning of section 643(i)(2)(B), with the following modifications:

(1) For purposes of applying section 267 (other than section 267(f)) and section 707(b)(1), “at least 10 percent” shall be substituted for “more than 50 percent” each place it appears;

(2) The principles of section 267(b)(10), substituting “at least 10 percent” for “more than 50 percent,” shall apply to determine whether two corporations are related; and

(3) The principles applicable to trusts shall apply to determine whether an estate is related to another person.

(f) *Examples.* The following examples illustrate the rules of this section. In each example, FT is an irrevocable foreign trust that is not treated as owned by any other person. The examples follow:

*Example 1. Related intermediary.* I, a nonresident alien who is not the grantor of FT, receives a distribution of stock from FT in the year 2001. In the year 2002, I sells the stock to an unrelated party for its fair market value of 100X and gives the 100X to his daughter, B, who is a U.S. resident. I is not an agent of either FT or B under generally applicable agency principles. Under paragraphs (a)(1) and (c)(2)(i) of this section, FT is deemed to have distributed 100X directly to B in the year 2002.

*Example 2. “But for” condition.* I, a foreign bank that is unrelated to any of the parties in these transactions, received a deposit of 500X from FT in the year 2001. In the year 2002, I transfers 400X to B, a United States person, in a transfer that it would not have made but for the fact that I had received 500X from FT. I is not an agent of either FT or B under generally applicable agency principles. Under paragraphs (a)(2) and (c)(2)(i) of this section, FT is deemed to have distributed 400X directly to B in the year 2002.

*Example 3. Tax avoidance purpose.* FT was created in 1980 by A, a nonresident alien. In the year 2001, FT’s trustee, T, determines that 1000X of accumulated income should be distributed to A’s U.S. granddaughter, B. Pursuant to a plan with a principal purpose of avoiding the interest charge that would be imposed by section 668, T causes FT to distribute 1000X to I, an unrelated foreign person. I subsequently transfers 1000X to B in the year 2001. Under paragraph (a)(3) of this section, B is deemed to have received an accumulation distribution from FT in the year 2001.

*Example 4. Amount not derived from foreign trust.* W and her husband, H, are both nonresident aliens. W’s son, S, is a U.S. resident. W receives annual income of 5000X from her own investments. Several years ago, H created and funded FT using his separate property. At the beginning of the year 2001, W receives a distribution of 100X from FT. There is no plan with a principal purpose of avoiding U.S. tax. At the end of the year 2001, W gives 100X of her investment income to S. None of the conditions in paragraph (a) of this section is satisfied. The transfer to S is treated as a nontaxable gift from W and not as an amount derived directly or indirectly from FT.

(g) *Effective date.* The rules of this section are applicable for transfers made by foreign trusts on or after August 20, 1996.

Par. 3. In § 1.671–2, paragraph (e) is revised to read as follows:

**§ 1.671–2 Applicable principles.**

\* \* \* \* \*

(e)(1) For purposes of subchapter J of the Internal Revenue Code, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer (within the meaning of paragraph (e)(4)(i) of this section) of property to a trust.

(2) A grantor includes a person who acquires an interest in a trust from a grantor of the trust if either—

(i) The transfer is nongratuitous (within the meaning of paragraph (e)(4)(ii) of this section); or

(ii) The transfer is of an interest in a fixed investment trust.

(3) If one person creates or funds a trust (or portion of a trust) primarily as an accommodation for another person, the other person shall be treated as a grantor of the trust (or portion of the trust).

(4)(i) A gratuitous transfer is any transfer other than a transfer for fair market value, or a corporate or partnership distribution. A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is a gift for gift tax purposes (see chapter 12 of subtitle B of the Internal Revenue Code).

(A) For purposes of this paragraph (e), a transfer for fair market value includes only transfers in consideration for property received from the trust, services rendered by the trust, or the right to use property of the trust. A transfer is for fair market value only to the extent that the value of the property received, services rendered, or the right to use property is equal to at least the fair market value of the property transferred. For example, rents, royalties, and compensation paid to a trust are transfers for fair market value only if the payments reflect an arm’s length price for the use of the property of, or services rendered by, the trust. For purposes of this determination, if a person contributes property to a trust (or to another entity that subsequently transfers the property (or proceeds therefrom) to a trust) in exchange for any type of interest in the trust (or other entity), such interest in the trust (or other entity) shall be disregarded in determining whether fair market value has been received. In addition, a person shall not be treated as making a transfer for fair

market value merely because the transferor recognizes gain on the transaction. For example, if a taxpayer elects to treat a transfer of appreciated property to a foreign trust as a deemed sale under section 1057, such a transfer will not be treated as a transfer for fair market value because the transferor did not receive actual fair market value consideration pursuant to the deemed sale.

(B) For purposes of this paragraph (e), a transfer to a trust is a corporate distribution, and therefore not a gratuitous transfer, only if it is a distribution described in section 301, 302, 305, 355 or 356. Similarly, for purposes of this paragraph (e), a transfer to a trust is a partnership distribution, and therefore not a gratuitous transfer, only if it is described in section 731. A distribution from one trust to another trust that is a beneficiary of the first trust is a gratuitous transfer.

(C) Notwithstanding any other provision of this paragraph (e), the district director may determine, based upon the facts and circumstances, that a direct or indirect transfer to a trust is more properly characterized as a gratuitous transfer if the transfer was structured with a principal purpose of avoiding U.S. tax. See, e.g., sections 643(a)(7) and 679(d).

(ii) For purposes of this paragraph (e), any transfer other than a gratuitous transfer is a nongratuitous transfer.

(5) The following examples illustrate the rules of this paragraph (e):

*Example 1.* A creates and funds a trust, T, for the benefit of her children. Under paragraph (e)(1) of the section, A is a grantor of T.

*Example 2.* A makes an investment in a fixed investment trust, T, that is classified as a trust under § 301.7701-4(c)(1) of this chapter. B subsequently acquires A's entire interest in T for fair market value. Under paragraph (e)(2) of this section, B is a grantor of T with respect to such interest.

*Example 3.* A, an attorney, creates a trust, T, for the benefit of his client, B, and B's children. The trust instrument names A as the grantor. A funds T with a nominal contribution out of his own funds. A views the contribution as an investment in the generation of fees for future legal services. Under paragraph (e)(3) of this section, B is a grantor of T.

*Example 4.* A, a U.S. citizen, creates and funds a trust, T, for the benefit of B. B holds an unrestricted power to withdraw any amount contributed to the trust for a period of 60 days after the contribution is made. B is treated as an owner of T under section 678 as a result of the withdrawal power. However, B is not a grantor of T under paragraph (e)(1) of this section as a result of the withdrawal power, because B neither created T nor made a gratuitous transfer to T.

*Example 5.* A contributes cash to a trust, T, through a broker, in exchange for units in T. The

value of the units in T is disregarded in determining whether A has received fair market value under paragraph (e)(4)(i)(A) of this section. Therefore, A has made a gratuitous transfer to T, and, under paragraph (e)(1) of this section, A is a grantor of T.

*Example 6.* A borrows cash from T, an unrelated trust. Arm's-length interest payments by A to T will not be treated as gratuitous transfers under paragraph (e)(4)(i)(A) of this section. Therefore, under paragraph (e)(1) of this section, A is not a grantor of T with respect to the interest payments.

*Example 7.* A creates and funds a domestic trust, DT. After A's death, DT distributes cash to a foreign trust, FT, that is a beneficiary of DT. Under paragraph (e)(4)(i)(B) of this section, the trust distribution by DT is a gratuitous transfer. Therefore, under paragraph (e)(1) of this section, DT is a grantor of FT with respect to such transfer.

*Example 8.* A creates and funds a trust, T. T owns stock of C, a publicly traded company, that pays a dividend to its shareholders, including T. The dividend paid by C is a nongratuitous transfer under paragraph (e)(4)(i)(B) of this section. Therefore, C is not a grantor under paragraph (e)(1) of this section with respect to the dividend.

*Example 9.* A, a nonresident alien, creates a trust, T, for the benefit of her spouse, B, who is a U.S. citizen. T is not treated as owned by any other person. A sells property worth \$1,000,000 to T in exchange for \$100,000 in cash. Under paragraph (e)(4)(i)(A) of this section, the \$900,000 excess is a gratuitous transfer by A. Therefore, A is a grantor of T under paragraph (e)(1) of this section with respect to such transfer.

(6) The rules of this paragraph (e) are applicable as of August 20, 1996.

Par. 4. Sections 1.672(f)-1, 1.672(f)-2, 1.672(f)-3, 1.672(f)-4, and 1.672(f)-5 are added to read as follows:

#### § 1.672(f)-1 Foreign persons not treated as owners.

(a) *General rule.* Section 672(f)(1) provides that sections 671 through 679 (the grantor trust rules) shall cause a person to be treated as the owner of any portion of a trust only to the extent such application results in an amount (if any) being currently taken into account (directly or through one or more entities) in computing the income of a citizen or resident of the United States or a domestic corporation. Section 672(f)(1) may apply only to a trust that would be treated as owned, in whole or in part, by a foreign person under the grantor trust rules without regard to section 672(f). For rules describing the application of this section, see paragraph (b) of this section. For definitions regarding the rules of this section, see paragraph (c) of this section. For examples illustrating the application of this section, see paragraph (d) of this section. For the effective date of the rules of this section, see paragraph (e) of this section.

(b) *Application of general rule—(1) Initial determination.* To determine

whether a trust is treated as owned by a foreign person, the taxpayer should first apply the grantor trust rules without regard to section 672(f) (the basic grantor trust rules) to determine the worldwide amount (as defined in paragraph (c)(1) of this section) and the U.S. amount (as defined in paragraph (c)(2) of this section).

(2) *Result.* The trust is treated as owned by a foreign person based on an annual comparison at the end of the trust's taxable year of the worldwide amount and the U.S. amount. If there is a worldwide amount and such amount is greater than the U.S. amount, under section 672(f) the foreign person shall not be treated as the owner of the portion of the trust attributable to the excess of the worldwide amount over the U.S. amount. Otherwise, the basic grantor trust rules shall apply without the limitation of section 672(f). For examples, see paragraph (d) of this section.

(c) *Definitions—(1) Worldwide amount.* The worldwide amount is the net amount of income, gains, deductions, and losses that would be taken into account for the current year under the basic grantor trust rules in computing the worldwide taxable income of any person, whether or not such person is a U.S. taxpayer (as defined in paragraph (c)(3) of this section). The worldwide amount is computed in accordance with U.S. principles of income taxation and includes amounts that would be attributable to foreign persons, without regard to whether such amounts are subject to U.S. income tax.

(2) *U.S. amount.* The U.S. amount is the net amount of income, gains, deductions, and losses that would be taken into account for the current year under the basic grantor trust rules (directly or through one or more entities) in computing the taxable income of a U.S. taxpayer (as defined in paragraph (c)(3) of this section). The U.S. amount includes amounts that would be attributable to the U.S. taxpayer even if the amount would not be includable in gross income (e.g., tax-exempt interest described in section 103(a)).

(3) *U.S. taxpayer.* A U.S. taxpayer is any person who is a U.S. citizen, a resident alien individual, a domestic corporation, a U.S. person who is treated as the owner of a trust under section 679, or a domestic trust to the extent such trust actually pays U.S. tax with respect to its income, gains, deductions, and losses.

(d) *Examples.* The following examples illustrate the rules of this section:

*Example 1. U.S. amount equals worldwide amount.* A, a citizen of the United States, creates and funds an irrevocable foreign trust, FT, for the benefit of his U.S. son, B. Under the basic grantor trust rules (see section 679), A would be treated as the owner of FT. For the taxable year ending December 31, 1999, FT has ordinary income of 100X, long-term capital gain of 200X, deductions of 20X, and short-term capital losses of 15X. Under paragraph (c)(1) of this section, the worldwide amount is 265X ( $100X + 200X - 20X - 15X$ ). Under paragraph (c)(2) of this section, the U.S. amount also is 265X. Consequently, under paragraph (b)(2) of this section, because the worldwide amount is equal to the U.S. amount, the basic grantor trust rules apply without the limitation of section 672(f) to treat A as the owner of FT.

*Example 2. No U.S. amount.* A, a nonresident alien, funds an irrevocable domestic trust, DT, for the benefit of his U.S. son, B. A has a reversionary interest within the meaning of section 673. If the basic grantor trust rules were applied, A would be treated as the owner of DT, and any distributions to B would be considered nontaxable gifts from A to B. Under paragraph (c)(2) of this section, there is no U.S. amount, because no amount is taken into account for the current year under the basic grantor trust rules in computing the taxable income of a U.S. taxpayer. Under paragraph (c)(1) of this section, the worldwide amount is equal to DT's net income. Under paragraph (b)(2) of this section, A is not treated as the owner of any portion of DT. Consequently, DT is a separate taxable entity, and distributions from DT to B must be taken into account in computing B's income.

*Example 3. U.S. amount less than worldwide amount.* FP is a foreign partnership for U.S. income tax purposes. FP has two partners: C, a nonresident alien, and D, a U.S. citizen. The partnership agreement provides that all income, gains, losses, deductions, and credits are allocated 50 percent to each partner. FP contributed cash to an irrevocable foreign trust, FT, primarily for the benefit of E, D's U.S. brother. FP can control the beneficial enjoyment of the trust assets within the meaning of section 674. If the basic grantor trust rules were applied, FT would be treated as the owner of FP. Because D's 50 percent distributive share of FP's income would be currently taken into account in computing the income of a U.S. citizen, the U.S. amount computed under paragraph (c)(2) of this section is equal to one half of the worldwide amount computed under paragraph (c)(1) of this section. Therefore, under paragraph (b)(2) of this section, FP is not treated as the owner of the portion of FT attributable to C's interest in FP. Such portion of FT will be treated as a separate taxable entity, and distributions by FT to E with respect to that portion of the trust will be considered distributions to E under section 662 and may be subject to the section 668 interest charge on accumulation distributions. (In addition, distributions from FP to E may be subject to recharacterization as purported gifts under § 1.672(f)-4.)

*Example 4. No worldwide amount.* USC is a U.S. corporation with a wholly owned foreign subsidiary, FC. USC funds an irrevocable foreign trust, FT, that cannot benefit any U.S. person. USC retains no power or interest that would cause it to be treated as the owner of FT under the basic grantor trust rules. However, FC is given a power

of appointment such that FC would be treated as the owner of FT under section 678. FT acquires a note issued by FC. FT has no items of income, deduction, losses, or credit other than income from the note. Under U.S. income tax principles, if the basic grantor trust rules were applied, FC would be treated as the owner of FT. Thus, FC would be treated as both the debtor and the creditor with respect to the note, and the note would be disregarded. Under paragraph (c)(1) of this section, there is no worldwide amount. Under paragraph (c)(2) of this section, there is no U.S. amount. Consequently, under paragraph (b)(2) of this section, the basic grantor trust rules apply without the limitation of section 672(f) to treat FC as the owner of FT.

*Example 5. Deemed contribution on effective date.* Assume the same facts as in Example 2. DT was created in 1990. On August 20, 1996, DT held accumulated income. Prior to August 20, 1996, A was treated as the owner of DT. A is deemed to have contributed the assets that were held in DT on August 20, 1996 to a new trust on that date.

(e) *Effective date.* The rules of this section are applicable as of August 20, 1996.

#### *§ 1.672(f)-2 Trusts created by certain foreign corporations.*

(a) *Controlled foreign corporations.* A controlled foreign corporation (as defined in section 957) that creates and funds a trust shall be treated as a domestic corporation for purposes of §§ 1.672(f)-1 through 1.672(f)-5 to the extent that, if the grantor trust rules without regard to section 672(f) (the basic grantor trust rules) were applied, income earned by the trust for the taxable year would be currently taken into account pursuant to section 951 in computing the gross income of a citizen or resident of the United States or a domestic corporation.

(b) *Passive foreign investment companies—(1) In general.* A passive foreign investment company (as defined in section 1296) that creates and funds a trust shall be treated as a domestic corporation for purposes of §§ 1.672(f)-1 through 1.672(f)-5 to the extent that, if the basic grantor trust rules were applied, income earned by the trust for the taxable year would be currently taken into account pursuant to section 1293 in computing the gross income of a citizen or resident of the United States or a domestic corporation.

(2) *Application of section 1296.* For purposes of determining whether a foreign corporation is a passive foreign investment company as defined in section 1296, the grantor trust rules shall be applied as if section 672(f) had not come into effect.

(c) *Foreign personal holding companies.* A foreign personal holding com-

pany (as defined in section 552) that creates and funds a trust shall be treated as a domestic corporation for purposes of §§ 1.672(f)-1 through 1.672(f)-5 to the extent that, if the basic grantor trust rules were applied, income earned by the trust for the taxable year would be currently taken into account pursuant to section 551 in computing the gross income of a citizen or resident of the United States or a domestic corporation.

(d) *Examples.* The following examples illustrate the rules of this section. In each example, FT is an irrevocable foreign trust, and CFC is a controlled foreign corporation. The examples follow:

*Example 1. Controlled foreign corporation without ultimate U.S. ownership.* Two nonresident aliens, A and B, create a domestic partnership, DP. DP's only asset is all the stock of CFC. CFC creates and funds FT to benefit A's U.S. daughter, C. CFC retains an administrative power over the trust as described in section 675. Thus, if the basic grantor trust rules were applied, CFC would be treated as the owner of FT, and distributions from FT to C would not be taxed as distributions under section 662. However, under paragraph (a) of this section, CFC is not treated as a domestic corporation for purposes of § 1.672(f)-1. Although CFC is a controlled foreign corporation (because CFC is owned by DP, a domestic person), no income earned by CFC will be included in the income of a U.S. taxpayer. Consequently, there is no U.S. amount under § 1.672(f)-1(c)(2). Under § 1.672(f)-1(b)(2), the basic grantor trust rules do not apply to treat CFC as the owner of FT. Transfers from FT to C are considered to be distributions to C under section 662 and may be subject to the section 668 interest charge on accumulation distributions. (In addition, distributions to C from DP, CFC, or FT may be subject to recharacterization as purported gifts under § 1.672(f)-4.)

*Example 2. Trust income is all subpart F income.* CFC is wholly owned by USC, a domestic corporation. CFC creates and funds FT for the benefit of USC. CFC can control the beneficial enjoyment of the trust assets within the meaning of section 674. All of FT's income is of the type that is subpart F income (as defined in section 952). FT does not distribute any income. Without regard to income earned by FT, CFC has a significant amount of earnings and profits. If the basic grantor trust rules were applied, CFC would be treated as the owner of FT, and all items of income of FT would be currently taken into account in computing the income of USC, a domestic corporation. Consequently, under paragraph (a) of this section, CFC is treated as a domestic corporation for purposes of § 1.672(f)-1. Under § 1.672(f)-1(b)(2), the basic grantor trust rules apply without the limitation of section 672(f) to treat CFC as the owner of FT. Distributions from FT to USC are treated as distributions from CFC to USC.

*Example 3. Portion of trust income is subpart F income.* Assume the same facts as in Example 2, except that FT also owns all of the stock of S, a corporation that is incorporated in the same country as CFC and that uses a substantial part of its assets in a trade or business in such country. Thus, dividends from S are not subpart F income. In the taxable year ending December 31, 1999, FT's only

income is subpart F income of 200X and dividends from S of 50X. FT has no deductions or losses for 199X. Under paragraph (a) of this section, CFC is treated as a domestic corporation for purposes of computing the U.S. amount under § 1.672(f)-1(c)(2) only to the extent FT's income is of the type that is subpart F income. Consequently, the U.S. amount is 200X. Under § 1.672(f)-1(c)(1), the worldwide amount is 250X. Under § 1.672(f)-1(b)(2), CFC is not treated as the owner of the portion of FT attributable to the excess of the worldwide amount over the U.S. amount. Such portion of FT will be treated as a separate taxable entity. Distributions to USP with respect to such portion of FT will be included in USP's income under section 662 and may be subject to the section 668 interest charge on accumulation distributions.

*Example 4. Reduction in portion of trust treated as nongrantor trust.* Assume the same facts as in *Example 3*. For each of the years 2001 through 2010, FT receives dividend income of 2X from S, none of which is distributed. In the year 2011, at a time when FT's basis in the stock of S is 80X, S sells its business and invests the proceeds in assets that generate subpart F income. CFC will now be treated as the owner of the portion of FT that had previously been treated as a separate taxable entity. FT will be deemed to have distributed 80X (the stock of S) to CFC. CFC will be required to include 20X of undistributed net income (2X a year for 10 years) in its income.

(d) *Effective date.* The rules of this section are applicable as of August 20, 1996.

#### § 1.672(f)-3 Exceptions to general rule.

(a) *Certain revocable trusts—(1) In general.* The general rule of § 1.672(f)-1(a) shall not apply to any portion of a trust if the power to vest absolutely in the grantor title to such portion is exercisable solely by the grantor without the approval or consent of any other person. If the grantor can exercise such power only with the approval of a related or subordinate party who is subservient to the grantor, such power will be treated as exercisable solely by the grantor. The grantor will be treated as having a power to vest only if the grantor has such power for a period or periods aggregating 183 days or more during the taxable year of the trust. See section 643(a)(7). For the definition of *grantor*, see § 1.671-2(e). For the definition of *related or subordinate party*, see § 1.672(c)-1. For purposes of this paragraph (a), a related or subordinate party is subservient to the grantor unless the presumption in the last sentence of § 1.672(c)-1 is rebutted by a preponderance of the evidence.

(2) *Grandfather rule—(i) In general.* The general rule of § 1.672(f)-1 shall not apply to a trust that was treated as owned by the grantor under section 676 on September 19, 1995, as long as the trust would continue to be so treated

under the basic grantor trust rules. However, such a trust will be subject to the general rule of § 1.672(f)-1 with respect to any portion of the trust attributable to transfers to the trust after September 19, 1995.

(ii) *Separate accounting for transfers after September 19, 1995.* In the case of a revocable trust that contains both amounts held in the trust on September 19, 1995, and amounts that were transferred to the trust after September 19, 1995, paragraph (a)(2)(i) of this section shall apply only if the amounts that were held in the trust on September 19, 1995, together with all income, gains, and losses derived therefrom (less all post-September 19, 1995, distributions therefrom) are separately accounted for from the amounts that were transferred to the trust after September 19, 1995, together with all income, gains, and losses derived therefrom (less all distributions therefrom). If there is no separate accounting, the general rule of § 1.672(f)-1 shall apply to the trust. If there is separate accounting, the general rule of § 1.672(f)-1 shall not apply to the portion of the trust that is attributable to amounts that were held in the trust on September 19, 1995.

(3) *Examples.* The following examples illustrate the rules of this paragraph (a):

*Example 1. Owner is grantor.* After September 19, 1995, FP1, a foreign person, creates and funds a revocable trust, T, for the benefit of FP1's children, who are U.S. residents. The trustee is a foreign bank, FB, that is owned and controlled by FP1 and FP2, who is FP1's brother. The power to revoke T and vest absolutely in FP1 title to the trust property is exercisable by FP1, but only with the approval or consent of FB. There are no facts that would suggest that FB is not subservient to FP1. Therefore, under paragraph (a)(1) of this section, T is not subject to the general rule of § 1.672(f)-1. FP1 is treated as the owner of T.

*Example 2. Owner not grantor.* Assume the same facts as in *Example 1*, except that FP1 dies. After FP1's death, FP2 has the power to withdraw the assets of T, but only with the approval of FB. There are no facts that would suggest that FB is not subservient to FP2. However, under paragraph (a)(1) of this section, T is now subject to the general rule of § 1.672(f)-1, because FP2 is not a grantor of T. FP2 is not treated as the owner of T.

*Example 3. Trustee not related or subordinate party.* Assume the same facts as in *Example 1*, except that neither FP1 nor any member of his family has any substantial ownership interest or other connection with FB. FP1 can remove and replace FB at any time for any reason. Although FP1 can replace FB if FB refuses to approve or consent to FP1's decision to vest the trust property in himself, FB is not a related or subordinate party. Therefore, under paragraph (a)(1) of this section, T is subject to the general rule of § 1.672(f)-1. FP1 will not be treated as the owner of T.

*Example 4. Unrelated trustee will consent to revocation.* FP, a foreign person, creates and funds an irrevocable trust, T. The trustee is a foreign bank, FB, that is not a related or subordinate party within the meaning of § 1.672(c)-1. FB has the discretion to distribute trust income or corpus to any person, including FP. Even if FB would in fact distribute all the trust property to FP if requested to do so by FP, under paragraph (a)(1) of this section, T is subject to the general rule of § 1.672(f)-1, because FP does not have the power to revoke T. FP will not be treated as the owner of T.

*Example 5. Husband treated as holding power held by wife.* H and his wife, W, both nonresident aliens, create and fund a trust, T, using community property. The power to revoke T and vest absolutely in H and W title to the trust property is exercisable either by W acting alone or by H with the consent of W. W has advised H that she will not consent to any decision by H to revoke T. Although W is a related or subordinate party to H within the meaning of § 1.672(c)-1, the presumption that W is subservient to H is rebutted by a preponderance of the evidence. However, pursuant to section 672(e), H is treated as holding the power to vest that is held by W. Therefore, under paragraph (a)(1) of this section, T is not subject to the general rule of § 1.672(f)-1. H and W are treated as the owners of T.

*Example 6. U.S. grantor of trust revocable by foreign person.* A, a nonresident alien, creates a revocable foreign trust, FT, and funds FT with \$5,000 cash. The only possible beneficiary of FT is a foreign person. B, a U.S. citizen, contributes \$1,000,000 of appreciated property to FT. B retains no powers that would cause B to be treated as an owner of any portion of FT under the grantor trust rules. Although A has the power to vest absolutely in itself title to the appreciated property, A is not a grantor of FT with respect to the appreciated property. See § 1.671-2(e). Therefore, under paragraph (a)(1) of this section, the portion of FT that is attributable to the appreciated property is subject to the general rule of § 1.672(f)-1. A is not treated as the owner of such portion.

(b) *Certain other trusts—(1) In general.* The general rule of § 1.672(f)-1(a) shall not apply to any trust (or portion of a trust) during the lifetime of the grantor if the only amounts distributable (whether income or corpus) from such trust (or portion of a trust) during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor. This paragraph (b) shall not apply to that portion of a trust from which, at any time after October 20, 1996, any amounts are distributable to any person other than the grantor or the spouse of the grantor. For purposes of this paragraph (b), payments of nongratuitous amounts (within the meaning of § 1.671-2(e)(4)(ii)) will not be considered amounts distributable. For the definition of *grantor*, see § 1.671-2(e).

(2) *Amounts distributable in discharge of legal obligation—(i) In general.* Subject to the provisions of paragraph (b)(2)(ii) of this section, amounts

that are distributable from a portion of a trust in discharge of a legal obligation of the grantor or the spouse of the grantor shall be treated as amounts distributable to the grantor or the spouse of the grantor for purposes of paragraph (b)(1) of this section. For this purpose, an obligation is considered a legal obligation if it is enforceable under the local law of the jurisdiction in which the grantor (or the spouse of the grantor) resides.

(ii) *Legal obligation to related person.* For purposes of paragraph (b)(2)(i) of this section, the term *legal obligation* does not include an obligation to a related person except to the extent the obligation was contracted bona fide and for adequate and full consideration in money or money's worth (see § 20.2043-1 of this chapter). For this purpose, a related person is a person described in § 1.643(h)-1(e).

(3) *Amounts distributable in discharge of support obligation.* Amounts that are distributable from a portion of a trust in discharge of the grantor's or the grantor's spouse's obligation to support a family member shall be treated as amounts distributable to the grantor or the spouse of the grantor only if the family member is an individual who would be treated as a dependent of the grantor or the grantor's spouse under sections 152(a)(1) through (8), without regard to the requirement that half of the individual's support be received from the grantor or the grantor's spouse, and the family member is either—

(i) Permanently and totally disabled (within the meaning of section 22(e)(3)); or

(ii) In the case of a son, daughter, stepson, or stepdaughter, less than 24 years old.

(4) *Grandfather rule—(i) In general.* The general rule of § 1.672(f)-1 shall not apply to a trust that was treated as owned by the grantor under section 677 (other than section 677(a)(3)) on September 19, 1995, as long as the trust would continue to be so treated under the basic grantor trust rules. However, such a trust will be subject to the general rule of § 1.672(f)-1 with respect to any portion of the trust attributable to transfers to the trust after September 19, 1995.

(ii) *Separate accounting for transfers after September 19, 1995.* In the case of a trust that contains both amounts held in the trust on September 19, 1995, and amounts that were transferred to the trust after September 19, 1995, para-

graph (b)(4)(i) of this section shall apply only if the amounts that were held in the trust on September 19, 1995, together with all income, gains, and losses derived therefrom (less all post-September 19, 1995, distributions therefrom) are separately accounted for from the amounts that were transferred to the trust after September 19, 1995, together with all income, gains, and losses derived therefrom (less all distributions therefrom). If there is no separate accounting, the general rule of § 1.672(f)-1 shall apply to the trust. If there is separate accounting, the general rule of § 1.672(f)-1 shall not apply to the portion of the trust that is attributable to amounts that were held in the trust on September 19, 1995.

(5) *Examples.* The following examples illustrate the rules of this paragraph (b):

*Example 1. Amounts distributable only to grantor or grantor's spouse.* H and his wife, W, are both nonresident aliens. H and W have a child, C, who is a U.S. resident. H creates and funds an irrevocable trust, FT, using only his separate property. The only amounts distributable (whether income or corpus) from FT as long as either H or W are alive are amounts distributable to H or W. Upon the death of both H and W, C may receive distributions from FT. Under paragraph (b)(1) of this section, FT is not subject to the general rule of § 1.672(f)-1 during H's lifetime. H is treated as the owner of FT.

*Example 2. Amounts temporarily distributable to person other than grantor or grantor's spouse.* Assume the same facts as in *Example 1*, except that C is a 30-year old law student at the time FT is created, FT is created after October 20, 1996, and the trust instrument provides that as long as C is in law school amounts may be distributed from FT to pay C's expenses. Thereafter, the only amounts distributable from FT as long as either H or W are alive will be amounts distributable to H or W. C's expenses are not treated as legal obligations of H or W under paragraph (b)(2)(ii) of this section or as support obligations under paragraph (b)(3) of this section. Therefore, under paragraph (b)(1) of this section, FT is subject to the general rule of § 1.672(f)-1(a). H is not treated as the owner of FT. After C graduates from law school, the general rule of § 1.672(f)-1 still will be applicable, and H still will not be treated as the owner of FT.

*Example 3. Grantor predeceases spouse.* Assume the same facts as in *Example 1*. H predeceases W. Under paragraph (b)(1) of this section, FT will become subject to the general rule of § 1.672(f)-1 upon H's death, because W is not a grantor. Accordingly, FT will be treated as a separate taxable entity upon H's death.

*Example 4. Effect of divorce.* H creates and funds a trust, FT, from which the only amounts distributable are amounts distributable to himself and A. At the time FT is created, A is H's wife. However, the trust document refers to A only by her name. H and A divorce. Under paragraph (b)(1) of this section, FT will be subject to the general rule of § 1.672(f)-1 after the divorce, because amounts will still be distributable to A,

and A will no longer be the spouse of the grantor. After the divorce, FT will be treated as a separate taxable entity.

*Example 5. Fixed investment trust.* FC, a foreign corporation, invests in a domestic fixed investment trust, DT, that is classified as a trust under § 301.7701-4(c)(1) of this chapter. The only amounts that are distributable from the portion of DT that is owned by FC are amounts distributable to FC. Under paragraph (b)(1) of this section, such portion of DT is exempt from the general rule of § 1.672(f)-1. FC is treated as the owner of its portion of DT.

*Example 6. Reinsurance trust.* A domestic insurance company, DI, reinsures a portion of its business with a foreign insurance company, FI. FI creates and funds an irrevocable domestic trust, DT, in the United States as security for its obligations under the reinsurance agreement. The trust funds are held by a U.S. bank and may be used only to pay claims arising out of the reinsurance policies. On the termination of DT, any assets remaining will revert to FI. The only amounts that are distributable from DT are distributable in discharge of FI's legal obligation. Therefore, under paragraph (b)(1) of this section, DT is exempt from the general rule of § 1.672(f)-1. FI is treated as the owner of DT.

*Example 7. Asset securitization trust.* A foreign corporation, FC, borrows money from a bank, B, to finance the purchase of an airplane. FC creates a foreign trust, FT, to hold the airplane as security for the loan from B. The only amounts that are distributable from FT are amounts distributable to B in the event that FC defaults on its loan from B. Thus, the only amounts distributable from FT are in discharge of FC's legal obligation to B. When FC repays the loan, the trust assets will revert to FC. Under paragraph (b)(1) of this section, FT is exempt from the general rule of § 1.672(f)-1. FC is treated as the owner of FT.

(c) *Compensatory trusts—(1) In general.* Except as provided in paragraph (c)(4) of this section, § 1.672(f)-1 does not apply to any portion of a trust distributions from which are taxable as compensation for services rendered. A trust described in this paragraph (c)(1) is referred to in this section as a compensatory trust.

(2) *Trusts classified as compensatory trusts.* The following types of trusts are the only types of trusts that shall be classified as compensatory trusts within the meaning of paragraph (c)(1) of this section—

(i) A qualified trust described in section 401(a) (but see § 1.641(a)-0(a));

(ii) A trust described in section 457(g);

(iii) A nonexempt employees' trust described in section 402(b) (see § 1.671-1(g) and (h));

(iv) A trust that is an individual retirement account described in section 408(k) or 408(p);

(v) A trust that is an individual retirement account the only contributions to which are rollover contributions listed in section 408(a)(1);

(vi) A trust that would be a nonexempt employees' trust described in section 402(b) but for the fact that the trust's assets are not set aside from the claims of creditors of the actual or deemed transferor within the meaning of § 1.83-3(e); and

(vii) A trust that is a welfare benefit fund described in section 419(e).

(3) *Other individual retirement accounts.* For rules that apply to individual retirement accounts (within the meaning of section 408(a)) that are not compensatory trusts within the meaning of paragraph (c)(1) of this section, see paragraphs (a) and (b) of this section.

(4) *Exceptions.* The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)-(ii)(b)), designate categories of compensatory trusts to which the general rule of paragraph (c)(1) of this section does not apply.

(d) *Effective date.* Except as provided in paragraph (b)(1) of this section, the rules of this section are applicable as of August 20, 1996.

#### § 1.672(f)-4 Recharacterization of purported gifts.

(a) *In general—(1) Purported gifts from partnerships.* Except as provided in paragraphs (b) and (f) of this section, and without regard to the existence of any trust, if a United States person (U.S. donee) directly or indirectly receives a purported gift or bequest (as defined in paragraph (d) of this section) from a partnership, the purported gift or bequest must be included in the U.S. donee's gross income as ordinary income.

(2) *Purported gifts from foreign corporations.* Except as provided in paragraphs (b) and (f) of this section, and without regard to the existence of any trust, if a U.S. donee directly or indirectly receives a purported gift or bequest (as defined in paragraph (d) of this section) from a foreign corporation, the purported gift or bequest must be included in the U.S. donee's gross income as if it were a distribution from the foreign corporation. For purposes of section 1012, the U.S. donee will not be treated as having basis in the foreign corporation. However, for purposes of section 1223, the U.S. donee will be treated as having a holding period in the foreign corporation on the date of the deemed distribution equal to the weighted average of the holding periods of the actual interest holders.

(b) *Exceptions—(1) U.S. partner or shareholder treats transfer as distribution and gift.* Paragraph (a) of this section shall not apply if the U.S. donee can establish that a U.S. citizen or resident alien who directly or indirectly holds an interest in the partnership or foreign corporation treated the purported gift as a distribution to the U.S. partner or shareholder and a subsequent gift to the U.S. donee.

(2) *Charitable contributions.* Paragraph (a) of this section shall not apply to U.S. donees that are described in section 170(c).

(c) *Certain distributions from trusts created by partnerships or foreign corporations.* If a partnership or foreign corporation is treated as the owner, under sections 671 through 679, of a portion of a trust from which property is distributed to a U.S. donee in a gratuitous transfer, the U.S. donee must treat the amount as a distribution from the partnership or foreign corporation. If a partnership or foreign corporation is not treated as the owner, under sections 671 through 679, of the portion of a trust from which property is distributed to a U.S. donee in a gratuitous transfer, the U.S. donee shall be taxable in the manner provided in paragraph (a) of this section only if the U.S. tax computed under that section exceeds the U.S. tax that would be due if the U.S. donee treats the amount as a distribution from the trust.

(d) *Definition of purported gift or bequest.* For purposes of this section, a purported gift or bequest is any transfer by a partnership or foreign corporation (other than a transfer for fair market value) to a person who is not a partner in the partnership or shareholder of the foreign corporation.

(e) *Effect on U.S. partner or shareholder.* This section applies only to computations of the U.S. donee's gross income. This section does not affect the U.S. tax treatment of a U.S. partner in the partnership or a U.S. shareholder of the foreign corporation.

(f) *Recharacterization by district director.* Notwithstanding any other provision in this section, if a U.S. donee receives a transfer that is subject to the rules of this section, the district director may recharacterize such transfer to prevent the avoidance of U.S. tax or clearly to reflect income. For example, the district director may determine, based upon the facts and circumstances, that a distribution from a partnership or for-

eign corporation is more properly characterized as a distribution from a trust.

(g) *De minimis exception.* This section shall not apply if, during the taxable year of a U.S. donee, the aggregate amount of purported gifts or bequests that is transferred to such U.S. donee directly or indirectly from a partnership or foreign corporation does not exceed \$10,000. The aggregate amount must include gifts or bequests from persons that the U.S. donee knows or has reason to know are related to the partnership or foreign corporation (within the meaning of section 643(i)).

(h) *Examples.* The following examples illustrate the rules of this section:

*Example 1.* FC is a foreign corporation that is wholly owned by A, a nonresident alien. FC distributes property directly to A's U.S. daughter, B, purportedly as a gift. Under paragraph (a)(2) of this section, B must treat the distribution as a dividend from FC. (However, if B can establish that the distribution exceeded FC's earnings and profits, B must treat such excess as an amount received in excess of basis under section 301(c)(3).) If FC is a passive foreign investment company, B must treat the amount as a distribution under section 1291. B will be treated as having the same holding period as A.

*Example 2.* FC is a foreign corporation that is wholly owned by A, a nonresident alien. FC creates and funds a revocable foreign trust, FT, from which a gratuitous transfer is made immediately to A's U.S. daughter, B. Thus, the transfer is out of trust corpus. FC is not treated as the owner of FT under sections 671 through 679. Under paragraph (c) of this section, B must treat the transfer as a dividend from FC, rather than a distribution from FT, if such treatment results in a higher U.S. tax liability.

(i) *Effective date.* The rules of this section are applicable for any transfer by a partnership or foreign corporation on or after August 20, 1996.

#### § 1.672(f)-5 Special rules.

(a) *Transfers by certain beneficiaries to foreign settlor—(1) In general.* If, but for section 672(f)(5), a foreign person would be treated as the owner of any portion of a trust, any U.S. beneficiary of such trust shall be treated as the owner of a portion of the trust to the extent the U.S. beneficiary directly or indirectly made transfers of property to such foreign person (without regard to whether the U.S. beneficiary was a U.S. beneficiary at the time of any transfer) in excess of transfers to the U.S. beneficiary from the foreign person. The rule of this paragraph will not apply to the extent the U.S. beneficiary can demonstrate to the satisfaction of the district director that the transfer by the U.S. beneficiary to the foreign person was wholly unrelated to any transaction in-

volving the trust. For purposes of this paragraph, a transfer of property does not include a nongratuitous transfer. See § 671–2(e)(4)(ii). In addition, a gift shall not be taken into account to the extent such gift would not be characterized as a taxable gift under section 2503(b). For a definition of *U.S. beneficiary*, see section 679.

(2) *Examples.* The following examples illustrate the rules of this section:

*Example 1.* A, a nonresident alien, contributes property to FC, a foreign corporation that is wholly owned by A. FC creates a foreign trust, FT, for the benefit of A and his children. FT is revocable by FC without the approval or consent of any other person. FC funds FT with the property received from A. A and his family move to the United States. Under paragraph (a)(1) of this section, A is treated as the owner of FT.

*Example 2.* B, a U.S. citizen, makes a gratuitous transfer of \$1 million to his uncle, C, a nonresident alien. C creates a foreign trust, FT, for the benefit of B and his children. FT is revocable by C without the approval or consent of any other person. C funds FT with the property received from B. Under paragraph (a)(1) of this section, B is treated as the owner of FT. (B also would be treated as the owner of FT as a result of section 679.)

(b) *Different taxable years.* If a person has a different taxable year (as defined in section 7701(a)(23)) from the taxable year of the trust, an amount is currently taken into account in computing the income of such person for purposes of § 1.672(f)-1 if the amount is taken into account for the taxable year of such person that includes the last day of the taxable year of the trust.

(c) *Entity characterization.* Entities generally shall be characterized under U.S. income tax principles. See §§ 301.7701–1 through 301.7701–4 of this chapter. However, for purposes of § 1.672(f)-4, a transferor that is a wholly owned business entity shall be treated as a corporation, separate from its single owner. See § 301.7701–2(c)(2)(iii) of this chapter.

(d) *Effective date.* The rules of this section are generally applicable as of August 20, 1996. However, the rules in paragraph (c) of this section shall not be applicable until [date of publication as a final regulation in the **Federal Register**].

## PART 301—PROCEDURE AND ADMINISTRATION

Par. 5. The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

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

Section 301.7701–2(c)(2)(iii) also is issued under 26 U.S.C. 643(a)(7), 672(f)(4) and (6).

Par. 6. Section 301.7701–2 is amended by adding paragraph (c)(2)(iii) to read as follows:

*§ 301.7701–2 Business entities; definitions.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iii) *Special rule for foreign business entities that make purported gifts.* For the purposes of applying the rules of section 672(f)(4), a wholly owned business entity shall be treated as a corporation, separate from its single owner.

\* \* \* \* \*

Michael P. Dolan,  
Acting Commissioner of Internal  
Revenue.

(Filed by the Office of the Federal Register on June 4, 1997, 8:45 a.m., and published in the issue of the Federal Register for June 5, 1997, 62 F.R. 30785)

26 CFR 601.204: *Changes in accounting periods and in methods of accounting.*

(Also Part I, §§ 168, 446, 481; 1.168(i)-1, 1.446-1.)

## Rev. Proc. 97-30

### SECTION 1. PURPOSE

This revenue procedure allows a taxpayer to make a general asset account election under § 168(i)(4) of the Internal Revenue Code for certain property that was placed in service in taxable years ending before October 11, 1994. The election set forth in this revenue procedure is available only for a taxable year ending in 1996 or 1997 (the year of change).

### SECTION 2. BACKGROUND

.01 Section 168(i)(4) provides that, under regulations, a taxpayer may maintain one or more general asset accounts for any property to which § 168 applies. The rules for general asset accounts are provided in § 1.168(i)-1 of the Income Tax Regulations, which allows a taxpayer to make an election to group assets into one or more general asset accounts. The assets in any particular account are depreciated as a single asset. Each general asset account generally includes only assets that are placed in service by the taxpayer in the same taxable year and that have the same

depreciation method, recovery period, convention, and asset class.

Section 1.168(i)-1 applies to property subject to § 168 that is placed in service in taxable years ending on or after October 11, 1994. For property subject to § 168 that was placed in service after December 31, 1986, in taxable years ending before October 11, 1994, § 1.168(i)-1(l) provides that the Internal Revenue Service will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts.

.02 Except as otherwise expressly provided, a taxpayer must obtain the consent of the Commissioner of Internal Revenue to change a method of accounting for federal income tax purposes. Section 446(e) and § 1.446-1(e)(2)(i). To obtain this consent, the taxpayer must file a Form 3115, Application for Change in Accounting Method, during the taxable year in which the taxpayer desires to make the proposed change. Section 1.446-1T(e)(3)(i).

.03 The Commissioner is authorized to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to obtain consent for effecting a change in method of accounting and to prevent amounts from being duplicated or omitted, including the taxable year or years in which the § 481(a) adjustment is to be taken into account. Section 1.446-1(e)(3)(ii).

### SECTION 3. GENERAL ASSET ACCOUNT ELECTION

.01 Subject to section 3.02 of this revenue procedure, a taxpayer may elect to apply the general asset account rules in § 1.168(i)-1 for any item of property: (1) depreciated by the taxpayer under § 168; (2) placed in service by the taxpayer after December 31, 1986, in any taxable year ending before October 11, 1994; (3) for which the taxpayer has not previously made a general asset account election; and (4) held by the taxpayer as of the beginning of the year of change.

.02 This election may be made only if the taxpayer has records that establish: (1) the taxable year in which the property was placed in service by the taxpayer; (2) the applicable depreciation method, recovery period, and convention under § 168 for the property; (3) the unadjusted depreciable basis (as defined in § 1.168(i)-1(b)(1)) of the property as of the beginning of the year of change; and (4) the depreciation allowed or

allowable, whichever is greater, for the property as of the end of the taxable year immediately preceding the year of change.

#### SECTION 4. EFFECT OF ELECTION

.01 *In general.* If a taxpayer makes a general asset account election under this revenue procedure, the taxpayer consents to, and agrees to apply, all of the provisions of § 1.168(i)-1 to the property subject to the election, beginning with the year of change. Thus, pursuant to § 1.168(i)-1(k)(1), the election generally is irrevocable and will be binding on the taxpayer for computing taxable income for the year of change and for all subsequent taxable years. The election has no effect on the depreciation method, recovery period, and convention of the property.

.02 *Establishment of general asset accounts.* Any property subject to a general asset account election under this revenue procedure must be grouped into one or more general asset accounts in accordance with the rules in § 1.168(i)-1(c) and separate from any account formed in any taxable year prior to the year of change. In addition, each general asset account must include a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account. The beginning balance for the unadjusted depreciable basis of the general asset account is equal to the sum of the unadjusted depreciable bases as of the beginning of the year of change for all property included in the general asset account. The beginning balance of the depreciation reserve of the general asset account is equal to the sum of the depreciation allowed or allowable, whichever is greater, as of the end of the taxable year immediately preceding the year of change for all property included in the general asset account.

#### SECTION 5. CHANGE IN METHOD OF ACCOUNTING

.01 *Consent.* A general asset account election for any item of property that is made pursuant to this revenue procedure is a change in method of accounting. Under § 1.446-1(e)(2)(i), the consent of the Commissioner is hereby granted to make this method change by any tax-

payer for any item of property for which a general asset account election is made pursuant to this revenue procedure. This consent is granted for the taxpayer's year of change. The consent is conditioned, however, on the taxpayer's complying with this revenue procedure. If the taxpayer does not comply with this revenue procedure, the taxpayer will be deemed to have initiated a change in method of accounting without obtaining the consent of the Commissioner required under § 446(e).

.02 *No § 481(a) adjustment.* Because the adjusted basis of the property is not changed by the general asset account election, the method change is made on a cut-off basis and, thus, no adjustment under § 481(a) is required or permitted.

.03 *Manner of making method change.*

(1) *Complete and file a current Form 3115.* The general asset account election under this revenue procedure is made on the taxpayer's timely filed original federal income tax return (including extensions) for the year of change or on an amended return for the year of change filed no later than December 20, 1997. The election is made by attaching a completed, current Form 3115 to the taxpayer's original or amended return for the year of change. The requirement to file a Form 3115 during the taxable year in which the taxpayer desires to make the proposed change is waived in accordance with § 1.446-1(e)(3)(ii).

(2) *No user fee.* No user fee is required for a Form 3115 filed under this revenue procedure. Any user fee that is submitted with any Form 3115 requesting permission to make a general asset account election under this revenue procedure will be returned to the taxpayer.

.04 *No protection from examination changes.* A general asset account election under this revenue procedure does not change the taxpayer's present method of computing depreciation allowances for the property subject to the election and, consequently, examination protection is not provided. Therefore, for any taxable year before the year of change, a taxpayer that receives consent to make a general asset account election under this revenue procedure does not thereby obtain protection from examination changes for the property included in the general asset account.

#### SECTION 6. EFFECTIVE DATE

An election may be made pursuant to this revenue procedure for a taxpayer's taxable year ending in 1996 or 1997.

#### SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97-27, 1997-21 I.R.B. 10, is modified.

#### DRAFTING INFORMATION

The principal author of this revenue procedure is Kathleen Reed of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mark Pitzer at (202) 622-3110 (not a toll-free call).

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#### Issuance of Taxpayer Assistance Orders (TAOs)

##### Delegation Order 232 (Rev. 3)

Effective: April 16, 1997.

*Authority:* To issue Taxpayer Assistance Orders (TAOs), other than TAOs involving a principal residence, under IRC § 7811, as amended by § 102 of Public Law 104-168 (Taxpayer Bill of Rights 2).

*Delegated to:* Assistant Commissioner (International); Regional Commissioners; District Directors and Assistant Directors; Service Center Directors and Assistant Directors; Regional, Service Center, District, and International Taxpayer Advocates.

*Redelegation:* This authority may be redelegated to an Associate Taxpayer Advocate.

*Authority:* To issue Taxpayer Assistance Orders (TAOs), under IRC § 7811, to release a principal residence of a taxpayer levied upon or to cease any action regarding a principal residence.

*Delegated to:* Regional Commissioners, Assistant Commissioner (International), and the Regional and International Taxpayer Advocates.

*Redelegation:* This authority may not be redelegated.

The authority to modify or rescind a TAO is limited by IRC § 7811(c), as amended by § 102(b) of Public Law 104-168, to only the Commissioner, Deputy Commissioner, and Taxpayer Advocate.

*Source of Authority:* Treasury Order 150–10.

This order supersedes Del. Order 232 (Rev. 2).

Dated April 16, 1997.

Lee R. Monks  
*Taxpayer Advocate.*

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## Information Reporting on Transactions With Foreign Trusts and on Large Foreign Gifts

### Notice 97–34

This notice provides guidance regarding the new foreign trust and foreign gift reporting provisions contained in the Small Business Job Protection Act of 1996 (the “Act”). The Act expands information reporting requirements under section 6048 of the Internal Revenue Code (the “Code”) for U.S. persons who make transfers to foreign trusts and for U.S. owners of foreign trusts. In addition, the Act adds new reporting requirements for U.S. beneficiaries of foreign trusts, extensively revises the civil penalties for failure to file information with respect to foreign trusts, and adds civil penalties for failure to report certain transfers to foreign entities. See sections 6048(c), 6677, and 1494(c). The Act also adds section 6039F to the Code, creating reporting requirements for U.S. persons who receive large gifts from foreign persons.

Notice 96–60, 1996–49 I.R.B. 7, provided that taxpayers would not be required to file information statements under section 6048(a) or be subject to associated penalties under section 6677 until further guidance was issued. Section VIII of this notice sets forth this further guidance.

This notice has eight sections. Section I explains the expected revisions to Forms 3520 and 3520–A. Section II provides certain definitions of terms used in this notice. Section III provides guidance on reporting of transfers to foreign trusts. Section IV explains the reporting responsibilities of U.S. owners of foreign trusts, including the information returns to be filed by these foreign

<sup>1</sup> There are currently two provisions of the Internal Revenue Code designated as section 6039F. The second provision was added by the Health Insurance Portability and Accountability Act of 1996 (HIPAA). Treasury intends to seek a technical correction to HIPAA to redesignate section 6039F as added by HIPAA as section 6039G. All subsequent references to section 6039F in this Notice relate to section 6039F as contained in the Small Business Job Protection Act of 1996.

trusts and the procedures for foreign trusts to appoint U.S. agents. Section V provides guidance regarding the new reporting requirements for U.S. beneficiaries of foreign trusts. Section VI explains the new reporting rules for U.S. persons who receive large gifts from foreign persons. Section VII provides guidance on the new penalties for failure to comply with these reporting requirements. Finally, Section VIII provides special transition rules.

Treasury and the Service expect to issue regulations incorporating the guidance set forth in this notice. Until such regulations are issued, taxpayers must comply with the guidance set forth in this notice.

### Section I. Revisions to Forms 3520 and 3520–A

Prior to the Act, a U.S. person who transferred property to a foreign trust was required to report the transfer on Form 3520, “Creation of or Transfers to Certain Foreign Trusts,” within 90 days of the transfer. In addition, U.S. owners of foreign trusts were required to file annually Form 3520–A, “Annual Return of Foreign Trust with U.S. Beneficiaries.” No reporting was required of U.S. beneficiaries of foreign trusts or of U.S. persons who received gifts from foreign persons.

In order to facilitate taxpayer compliance and reduce duplicative reporting requirements, the Service is developing a revised Form 3520 (“Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts”) that generally will allow U.S. persons to use a single form to comply with all of the new reporting requirements of the Act pertaining to transactions with foreign trusts and the receipt of foreign gifts. In addition, Form 3520–A will be revised so that foreign trusts will be able to use that form to meet the new information reporting requirements of section 6048(b). U.S. owners of foreign trusts will no longer be required to file Form 3520–A.

### Section II. Definitions

For purposes of this notice, the terms “grantor,” “beneficiary,” and “obligation” are defined as follows.

A “grantor” includes any person who creates a trust as well as any person who directly or indirectly makes a gratuitous transfer of money or other property to a trust. A grantor includes a person who acquires an interest in a

trust in a nongratuitous transfer from a person who is a grantor of the trust. A grantor also includes an investor who acquires an interest in a fixed investment trust from a grantor of the trust. If one person creates or funds any portion of a trust primarily as an accommodation for another person, the other person will be treated as the grantor with respect to such portion of the trust. Gratuitous transfers are described below in Section III.

A “beneficiary” includes any person that could possibly benefit (directly or indirectly) from the trust at any time (including any person who could benefit if the trust were amended), whether or not the person is named in the trust instrument as a beneficiary and whether or not the person can receive a distribution from the trust in the current year. Sections 679(c), 643(a)(7). *See also* H.R. Rep. No. 658, 94th Cong., 1st Sess. 210 (1975), 1976–3 (vol. 2) C.B. 902. However, for purposes of sections 643(i), 679(a)(3)(C) and 1494, a person will not be considered a beneficiary if, based on all relevant facts and circumstances, it could not be reasonably anticipated that the person could possibly benefit from the trust. For example, for this purpose a publicly-traded corporation would generally not be treated as a beneficiary of a family’s trust even if the trustee is given complete discretion to distribute trust income to anyone. However, friends and business associates of the family would be considered beneficiaries of such a trust because it could be reasonably anticipated that the trust could possibly benefit such persons.

An “obligation” includes 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.

### Section III. Transfers to Foreign Trusts

This section of the notice provides guidance for the reporting of transfers to foreign trusts. As more fully described below, gratuitous transfers are reportable under section 6048(a). For this purpose, a gratuitous transfer is any transfer other than: (a) a transfer for fair market value, or (b) a corporate or partnership distribution. In addition, as more fully described below, nongratuitous transfers (all transfers other than gratuitous transfers) to a foreign trust are reportable

under section 1494 if: (a) the U.S. transferor does not immediately recognize all of the gain on the transfer (or recognizes gain solely by reason of an election under section 1057), or (b) the U.S. transferor is related to the trust. If a transfer is gratuitous in part and nongratuitous in part, the gratuitous portion of the transfer must be reported under section 6048 and the nongratuitous portion of the transfer must be reported under section 1494.

## A. Background

Section 6048(a) generally provides that any U.S. person who directly or indirectly transfers money or other property to a foreign trust (including a transfer by reason of death) must report such transfer at the time and in the manner prescribed by the Secretary. Section 6048(a)(2). Transfers to foreign trusts described in sections 402(b), 404(a)(4), or 404A, or trusts determined by the Secretary to be described in section 501(c)(3) are not reportable under these requirements. Section 6048(a)(3)(B)(ii). Transfers involving fair market value sales are also not reportable. Section 6048(a)(3)(B)(i). The Secretary may exempt other types of transfers from being reported if the United States does not have a significant interest in obtaining the required information. Section 6048(d)(4). A person who fails to comply with the reporting requirements of section 6048(a) with respect to a transfer occurring after August 20, 1996, will be subject to a 35 percent penalty on the gross value of the property transferred. Section 6677(a).

One of the purposes of the reporting requirements in section 6048(a) is to ensure that U.S. transferors comply with section 679. Section 679 generally treats a U.S. person as the owner of a foreign trust if the U.S. person transfers property to the foreign trust and the trust could benefit a U.S. person. However, a U.S. person will not be treated as the owner of the trust under section 679 if, in exchange for the property transferred to the trust, the U.S. person receives property whose value is at least equal to the fair market value of the property transferred. Section 679(a)(2)(B).

Certain transfers of property by U.S. persons to foreign trusts may be de-

<sup>2</sup> As explained in Notice 97-18, Treasury and the Service are studying whether distributions by domestic corporations and partnerships should be reportable under section 1494. This notice does not affect the reporting of such corporate or partnership distributions.

scribed in section 1491 as well as section 6048(a). Section 1491 generally provides that a U.S. person who transfers property to a foreign trust is subject to a 35 percent excise tax on any unrecognized gain in the transferred property. Section 1494 generally provides that transfers described in section 1491 to certain foreign entities (including foreign trusts) must be reported. Notice 97-18, 1997-10 I.R.B. 35, provided that in the case of transfers to foreign trusts, reporting obligations under section 1494 may be satisfied if the U.S. transferor complies with its reporting obligations under section 6048(a) and the U.S. transferor does not owe excise tax under section 1491.

## B. Section 6048(a) Information Reporting

Except as otherwise provided in Section III.E., a U.S. person must report under section 6048(a) any gratuitous transfer to a foreign trust. Although nongratuitous transfers generally are not reportable under section 6048(a), any transfer in exchange for an obligation that is treated as a qualified obligation (as defined in section III.C.2) must also be reported under section 6048(a). In the event of a reportable transfer occurring by reason of death, the executor, as defined in section 2203, is responsible for reporting the transfer.

A gratuitous transfer is any transfer other than (i) a transfer for fair market value, or (ii) a corporate or partnership distribution. A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is a gift for gift tax purposes (see Chapter 12 of Subtitle B of the Code). A gratuitous transfer to a foreign trust must be reported on Form 3520.

For purposes of this notice, a transfer for fair market value includes only transfers in consideration for property received from the trust, services rendered by the trust, or the right to use property of the trust. A transfer is for fair market value only to the extent that the value of the property received, services rendered, or the right to use the property is equal to the fair market value of the property transferred. For example, rents, royalties, and compensation paid to a trust are transfers for fair market value only if the payments reflect an arm's length price for the use of the property of, or services rendered by, the trust.

For purposes of this determination, if a U.S. person contributes property to a

trust in exchange for any type of interest in the trust, such interest in the trust will be disregarded in determining whether fair market value has been received. In addition, a U.S. person will not be treated as making a transfer for fair market value merely because the transferor recognizes gain on the transaction. For example, if a taxpayer elects to treat a transfer of appreciated property to a foreign trust as a deemed sale under section 1057, such a transfer will not be treated as a transfer for fair market value because the transferor did not receive actual fair market value consideration pursuant to the deemed sale. For special rules regarding obligations issued by related foreign trusts, see Section III.C. below.

For purposes of this notice, a transfer to a foreign trust is a corporate distribution, and therefore not a gratuitous transfer, only if it is a distribution described in sections 301, 302, 305, 355, or 356. Similarly, for purposes of this notice, a transfer to a foreign trust is a partnership distribution, and therefore not a gratuitous transfer, only if it is described in section 731. A distribution from one trust to another trust that is a beneficiary of the first trust is a gratuitous transfer. Moreover, a domestic trust that becomes a foreign trust is deemed to have made a gratuitous transfer of all its assets immediately before becoming a foreign trust. See section 1491.

Notwithstanding any other guidance provided by this notice, a gratuitous transfer also includes any direct or indirect transfer that is structured with a principal purpose of avoiding the application of sections 679 or 6048. See sections 643(a)(7), 679(d), and 6048(a).

## C. Trust Obligations

### 1. Background

Congress was concerned that certain taxpayers may have attempted to avoid the application of sections 679 and 6048(a) by transferring property to a foreign trust in exchange for obligations issued by the trust. H.R. Rep. No. 542, 104th Cong., 2d Sess., pt. 2 at 25 (1996). Thus, the Act provides that if a U.S. person transfers money or other property to a related foreign trust, any obligation issued by the trust (or any obligation of a person related to the trust) will not be taken into account in determining if the U.S. person received fair market value, except to the extent provided by regulations. Sections 679(a)(3)(A)(i), 6048(a)(3)(B)(i). For

purposes of determining whether an obligation is disregarded, a person is related to a trust if, without regard to the transfer, the person is a grantor of the trust, a beneficiary of the trust, or a person who is related (within the meaning of section 643(i)(2)(B)) to any grantor or beneficiary of the trust. Section 679(a)(3)(C).

Congress nevertheless intended that Treasury and the Service would exercise regulatory authority to allow certain trust obligations to be taken into account in determining whether such a transferor has received fair market value. In exercising this regulatory authority, Congress expected that Treasury and the Service would give consideration to whether there is a reasonable expectation that an obligation of the trust would be repaid. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 335 (1996).

## 2. Qualified Obligations

Where a U.S. person transfers money or other property to a related foreign trust in exchange for an obligation from that trust (or an obligation of a person related to such trust), regulations will provide that the obligation will be taken into account for purposes of section 679 in determining whether the U.S. transferor received fair market value from the foreign trust only if the obligation is a "qualified obligation."

An obligation is 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 of the obligation is not less than 100 percent of the applicable Federal rate and not greater than 130 percent of the applicable Federal rate (the applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin);

(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. person's taxable year and is paid within such period); when properly executed and filed, such an agreement will be deemed to be consented to by the Service Center Director or the Assistant Commissioner (International) for purposes of § 301.6501(c)-1(d); and

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

If, while the original obligation is outstanding, the U.S. transferor or a person related to the trust 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 will be 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) will be 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.

If an obligation treated as a qualified obligation subsequently fails to be a qualified obligation (e.g., a renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. transferor will be treated as making a gratuitous 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 gratuitous transfer will not exceed the issue price of the subsequent obligation. The subsequent obligation will be separately tested to determine if it is a qualified obligation.

Generally, as discussed above, a gratuitous transfer resulting from a failed qualified obligation will be 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 facts and circumstances, the district director may deem a gratuitous 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 district director could deem the transfer to have occurred on the issue date of the original obligation. A demand loan does not have a specified term and, therefore, cannot be a "qualified obligation." In addition, an annuity contract cannot be a "qualified obligation."

The rules for qualified obligations apply to an obligation of a related foreign trust (or of a person related to the trust) issued after February 6, 1995, whether or not in accordance with a preexisting arrangement or understanding. For purposes of these rules, 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 contained in revised section 6677 will only apply to the failure to report transfers in exchange for obligations issued after August 20, 1996.

## D. Section 1494 Information Reporting

Notwithstanding that nongratuitous transfers of property generally are not reportable under section 6048(a), fair market value transfers must nevertheless be reported on Form 3520 pursuant to section 1494 if:

(i) The U.S. transferor (other than a person described in Part II.A.1.i. through iii. of Notice 97-18, 1997-10 I.R.B. 35) makes a nongratuitous transfer of appreciated property to a foreign trust and does not immediately recognize all of the gain on the property transferred (or recognizes gain only by reason of an election described in section 1057); or

(ii) The U.S. transferor is related to the trust. A transferor is considered related to the trust if the transferor is the grantor of the trust, a beneficiary of the trust, or a person related to a grantor or beneficiary (applying the principles of section 643(i)(2)(B), as modified by Section II.A.2. of Notice 97-18, 1997-10 I.R.B. 35).

If such a nongratuitous transfer to a foreign trust is reportable under section 1494, the transfer must be reported on Form 3520 in a manner comparable to the manner for reporting transactions with other foreign entities on Form 926 ("Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership"). *See* Notice 97-18, Section III.C. Thus, if a U.S. person transfers appreciated property to a foreign trust and does not immediately recognize the entire amount of gain on the transfer (or recognizes gain only by reason of an election described in section 1057), the transferor must separately identify the property transferred. However, if the transferor recognizes the gain (if any) on the property transferred, but the transferor is related to the foreign trust, the transferor may aggregate the amounts transferred to the trust during the year, using the categories set forth in Section III.C. of Notice 97-18.

The transferor will not be required to file a separate Form 926 in addition to Form 3520 unless the transferor owes excise tax under section 1491 with respect to a transfer. Elections under section 1057 to avoid the section 1491 excise tax can be made on Form 3520.

## E. Deferred Compensation and Charitable Trusts

Without regard to whether a transfer to a foreign trust is gratuitous or nongratuitous, transfers to foreign trusts described in sections 402(b), 404(a)(4), 404A, or 501(c)(3) are exempt from reporting under section 6048(a). Section 6048(a)(3)(B)(ii). For purposes of this provision, a trust will be considered described in section 501(c)(3) only if it has a determination letter from the Service that has not been revoked recognizing its status as exempt from income taxation under section 501(a).

Section 6048(d)(4) authorizes the Secretary to suspend requirements of section 6048 as appropriate. Based on this authority, no reporting will be required under section 6048(a) on transfers to Canadian Registered Retirement Savings Plans (RRSPs) if the trust would qualify for treaty benefits at the time of the transfer under the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital. Any U.S. person relying on a tax treaty with Canada to avoid information reporting must, however, disclose this position under section 6114.

Furthermore, the Secretary has determined that, if a foreign trust is described in sections 402(b), 404(a)(4), 404A or 501(c)(3), or is an RRSP, and a transfer to such trust would be exempt from reporting under section 6048(a) pursuant to this notice, no reporting is required with respect to any transfer to that trust under section 1494. Thus, no penalty will apply under sections 6677 or 1494(c) with respect to the failure to report any transfer to such a trust.

Comments are solicited concerning whether other categories of transfers to foreign trusts should be exempt from reporting under sections 6048(a) and 1494.

## F. Examples

The following examples illustrate the rules in this Section II. In these examples, A is a U.S. citizen, DC is a domestic corporation, DT is a domestic trust that is not treated as owned by any other person, and FT is a foreign trust.

*Example 1. Contribution to FT.* A contributes cash to FT, through a broker, in exchange for units in FT. The value of the units in FT is disregarded in determining whether A has received fair market value. Therefore, the contribution by A is a gratuitous transfer and A must report the contribution to FT under section 6048(a).

*Example 2. Interest payment to FT.* A borrows cash from FT, an unrelated foreign trust. Arm's-length interest payments by A will not be treated as gratuitous transfers. Thus, A is not required to report the payments under section 6048(a). In addition, A is not required to report the payments under section 1494, since A is not related to the trust.

*Example 3. Trust distribution to FT.* A created and funded DT. After A's death, DT distributes cash to FT, which is a beneficiary of DT. The trust distribution by DT is a gratuitous transfer. DT must report the distribution under section 6048(a).

*Example 4. Dividend payment to FT.* A creates and funds FT. FT owns stock of DC, a publicly traded company, which pays a dividend to FT. The dividend paid by DC is not a gratuitous transfer. Thus, DC is not required to report the dividend to FT under section 6048(a).

*Example 5. Right to withdraw.* F, a foreign individual, creates FT and contributes \$10,000 to FT. In addition, A transfers \$10,000,000 to FT. A retains no power over FT. F has the right to withdraw all of FT's property. A must report the transfer of \$10,000,000 to FT under section 6048(a).

*Example 6. Anti-abuse rule.* FT is created by a foreign person to benefit B, A's child, who is a U.S. citizen. FT is not treated as owned by any other person. On December 1, 1998, A creates a limited partnership and contributes property worth \$1,000,000 to the limited partnership. On March 1, 1999, with a principal purpose to avoid the application of section 679, A sells a 25 percent interest in the limited partnership to the trust in exchange for \$185,000 (A takes the position that \$185,000 reflects the fair market value of the 25 percent interest because of a

discount for the minority interest.) Even if the fair market value of the minority interest in the limited partnership was only \$185,000 at the time of the transfer, the \$65,000 minority discount will be treated as a gratuitous transfer as of March 1, 1999, for purposes of section 679 and 6048 because the transaction was designed to avoid section 679. Therefore, A must report the \$65,000 minority discount under section 6048(a) in 1999. A must also report the \$185,000 under section 1494 in 1999, since A is related to the foreign trust.

*Example 7. Nonqualified obligation.* A, the father of a U.S. beneficiary of FT, sells property worth \$1,000,000 to FT in exchange for an obligation issued by FT. The obligation is not a "qualified obligation." Thus, A's sale to FT will be treated as a gratuitous transfer and A must report the transfer under section 6048(a). A will also be treated as owning for purposes of section 679 the portion of the trust attributable to the property worth \$1,000,000 that he transferred to the trust.

*Example 8. Qualified obligation.* A, a beneficiary of FT, sells property on January 1, 1998, worth \$1,000,000 to FT in exchange for an obligation issued by FT due on January 1, 2001, with a stated interest rate equal to 100 percent of the applicable Federal rate. FT is not treated as owned by any other person. To ensure that the obligation is a qualified obligation, A must report the transfer for purposes of section 6048(a), properly extend the statute of limitations for each year in which the obligation is outstanding, and report annually on the status of the obligation. Provided A complies with these requirements, the obligation is a qualified obligation and A has not made a gratuitous transfer to the trust in 1998 for purposes of section 6048.

*Example 9. Subsequent transfer while qualified obligation is outstanding.* Assume the same facts as *Example 8*, except that A's father, C, who is not a U.S. person, also loaned FT \$900,000 on December 1, 2000, when the adjusted issue price on FT's original obligation to A is \$800,000, plus accrued but unpaid interest of \$10,000. FT's obligation to C has a maturity date of December 1, 2004, more than five years after the issue date of A's original obligation. Because A is related to C, A's original obligation is treated as having a maturity date of December 1, 2004. Thus, A will be treated as having made a gratuitous transfer to FT of \$810,000 as of December 1, 2000. A must report this transfer on Form 3520 for the year 2000. However, if as of the date of A's original transfer A knew or had reason to know that the obligation would not be repaid, the district director could determine that A made a gratuitous transfer to FT of \$1,000,000 as of January 1, 1998.

*Example 10. Nongratuitous bank loan to FT.* A funds FT with a contribution of \$1,000,000. A's grandchildren, who are U.S. citizens, are the only possible beneficiaries of FT. A is treated as the owner of FT under section 679. FT borrows money from an unrelated U.S. bank at arm's length terms to purchase U.S. real property. U.S. bank has made a nongratuitous transfer to FT, and is not required to report the transfer for purposes of section 6048(a).

*Example 11. Non-arm's length sale to related FT.* FT is created by a foreign person to benefit B, A's spouse, who is a U.S. citizen. FT is not treated as owned by any other person. A sells property worth \$1,000,000 to FT in exchange for \$100,000 in cash. The \$900,000 excess is a

gratuitous transfer by A. A must report this excess under section 6048(a). A must also report the \$100,000 under section 1494, since A is related to FT.

*Example 12. Nongratuitous transfer to related FT.* FT is created by a foreign person to benefit B, A's spouse, who is a U.S. citizen. FT is not treated as owned by any other person. The office building in which A conducts his U.S. business is owned by FT. A makes fair market value rental payments to FT. A's rental payments are not gratuitous transfers. Thus, A is not required to report the rental payments under section 6048(a). However, A must report the aggregate amount of the rental payments on an annual basis under section 1494 since A is related to FT.

*Example 13. Transfer that is gratuitous in part and nongratuitous in part.* Assume the same facts as *Example 12*, except that A's rental payments to FT are in excess of fair market value. The portion of each of A's rental payments that is in excess of fair market value is a gratuitous transfer. Thus, A must report the excess portion of each payment under section 6048(a). In addition, A must report the fair market value portion of the payments under section 1494.

#### Section IV. U.S. Owners of Foreign Trusts.

Each U.S. person treated as an owner of a foreign trust under sections 671 through 679 is responsible for ensuring that the foreign trust files an annual return setting forth a full and complete accounting of all trust activities, trust operations and other relevant information. Section 6048(b)(1). In addition, the U.S. owner is responsible for ensuring that the trust annually furnishes such information as the Secretary prescribes to U.S. owners and U.S. beneficiaries of the trust. Section 6048(b)(1)(B). If the trust does not furnish this information, the U.S. owner is subject to a penalty equal to 5 percent of the gross value of the portion of the trust's assets treated as owned by that person. Section 6677(b) and (c)(2). The penalty applies to taxable years of U.S. owners beginning after December 31, 1995.

##### A. Annual Return

The Service plans to revise Form 3520-A to allow that form to be used by foreign trusts to satisfy their annual information reporting requirements. Until the revised Form 3520-A is available, the U.S. owner must ensure that a trustee who is authorized to sign Form 3520-A: (1) files the unrevised Form 3520-A, (2) writes "FOREIGN GRANTOR TRUST" at the top of the form, (3) completes the identifying information on the form as if the foreign trust were the U.S. owner required to file the form, (4) signs the form, (5)

attaches a Foreign Grantor Trust Information Statement to the form, (6) sends a Foreign Grantor Trust Owner Statement (see part 4 of the Foreign Grantor Trust Information Statement) to each U.S. owner of a portion of the trust, and (7) sends a copy of a Foreign Grantor Trust Beneficiary Statement (see part 5 of the Foreign Grantor Trust Information Statement) to each U.S. beneficiary who received a distribution from the trust during the taxable year. Except as provided in Section VIII, Form 3520-A must be filed and the required statements furnished to the U.S. grantors and U.S. beneficiaries by the fifteenth day of the third month after the end of the trust's taxable year (or later, if pursuant to an extension of time to file). See Section VIII for special filing deadlines for filing Form 3520-A for 1996.

The Foreign Grantor Trust Information Statement should be submitted in substantially the following format:

#### FOREIGN GRANTOR TRUST INFORMATION STATEMENT

##### 1. Foreign Trust Background Information

- A. Name, address and employer identification number ("EIN") of trust
- B. Name, address and taxpayer identification number ("TIN") of the U.S. agent (if any)
- C. Name, address and TIN (if any) of the trustee who signed Form 3520-A
- D. Method of accounting used by the trust (cash or accrual)
- E. The taxable year of the foreign trust to which the statement applies

##### 2. Foreign Trust Balance Sheet. The foreign trust balance sheet should contain both beginning and end of year balances. Amounts may be aggregated within each category listed below and should be stated at their approximate fair market value. A good faith estimate of fair market value is satisfactory.

- A. Assets
  1. Cash
  2. Accounts receivable
  3. Inventory
  4. Government obligations
  5. Other marketable securities
  6. Other non-marketable securities
  7. Depreciable (depletable) assets
  8. Real property
  9. Other assets (attach summary schedule)
  10. Total assets

##### B. Liabilities

1. Accounts payable
2. Contributions, gifts, grants, etc. payable
3. Mortgages and notes payable
4. Other liabilities (attach summary schedule)
5. Total liabilities

##### C. Retained Earnings

1. Contributions
2. Accumulated trust income
3. Other (state nature)
4. Total net worth

##### 3. Foreign Trust Income Statement. Use U.S. tax principles to determine the trust's income.

###### A. Income

1. Interest
2. Dividends
3. Rents, royalties, distributive share of partnership income, etc.
4. Capital gains
  - a. Net short-term capital gain
  - b. Net long-term capital gain
5. Other (state nature)
6. Total income

###### B. Deductions

1. Interest
2. Foreign taxes
3. State and local taxes
4. Trustee and advisor fees
5. Amortization and depreciation
6. Other (state nature)
7. Total deductions

###### C. Net Income or loss (A.6. less B.7.)

###### D. Distributions to beneficiaries (separately state for each U.S. beneficiary)

###### E. Tax credits (attach summary schedule)

##### 4. The Foreign Grantor Trust Owner Statement

###### A. Foreign Trust Background Information

1. Name, address and EIN of trust
2. Name, address and TIN of U.S. agent (if any)
3. Name, address and TIN (if any) of the trustee who signed Form 3520-A

4. Method of accounting used by the trust (cash or accrual)
5. The taxable year of the foreign trust to which the statement applies

6. Name, address and TIN of the U.S. owner
7. A good faith estimate of the U.S. owner's gross reportable amount (the fair market value of the trust's assets treated as owned by the U.S. person)

- B. Statement of Net Income Attributable to the Owner. Use U.S. tax principles to determine the owner's income.
1. Income attributable to the owner
    - a. Interest
    - b. Dividends
    - c. Rents, royalties, distributive share of partnership income, etc.
    - d. Capital gains
      1. Net short-term capital gain
      2. Net long-term capital gain
    - e. Other (state nature)
    - f. Total income
  2. Deductions attributable to the owner
    - a. Interest
    - b. Foreign taxes
    - c. State and local taxes
    - d. Trustee and advisor fees
    - e. Amortization and depreciation
    - f. Other (state nature)
    - g. Total deductions
  3. Net Income or loss attributable to the owner (B.1.f. less B.2.g.)
  4. Tax credits attributable to the owner (attach summary schedule)
5. The Foreign Grantor Trust Beneficiary Statement
- A. Foreign Trust Background Information
1. Name, address and EIN of trust
  2. Name, address and TIN of U.S. agent (if any)
  3. Name, address and TIN (if any) of the trustee who signed Form 3520-A
  4. The taxable year of the foreign trust to which the statement applies
- B. U.S. Beneficiary Information
1. Name, address and TIN of U.S. Beneficiary
  2. A description of the property (including cash) distributed or treated as distributed to the U.S. person during the taxable year, and the fair market value of the property distributed.
- C. Owner Information.
1. An explanation of the facts and law (including the section of the Internal Revenue Code) that establishes that the foreign trust (or the portion of the foreign trust from which the beneficiary received a distribution) is treated for U.S. tax purposes as owned by another person.

2. A statement identifying whether the owner of the foreign trust (or the portion of the foreign trust from which the beneficiary received a distribution) is an individual, trust, corporation or partnership, and whether that person is a U.S. or foreign person. If the owner is a U.S. person, a foreign partnership, a foreign corporation, or a foreign trust, attach the name, address and TIN (if any) of the owner.

### **B. Appointment of U.S. Agent.**

If a foreign trust with a U.S. owner does not have a U.S. agent, the Secretary may determine the amounts required to be taken into account with respect to the foreign trust by the U.S. owner. Section 6048(b)(2). In order to avoid this result, a U.S. owner of a foreign trust should ensure that the foreign trust appoints a U.S. person to act as the foreign trust's limited agent for purposes of applying sections 7602, 7603, and 7604 with respect to a request by the Secretary to examine records or produce testimony, or a summons by the Secretary for such records or testimony. Any U.S. citizen, resident alien, or domestic corporation (including a U.S. grantor or U.S. beneficiary of a foreign trust) may act as the U.S. agent of the trust.

In order to authorize a U.S. person to act as an agent under section 6048(b), the trust and the agent must enter into a binding agreement substantially in the form that follows:

#### **AUTHORIZATION OF AGENT**

[Name of foreign trust] hereby expressly authorizes [name of U.S. agent] to act as its agent solely for purposes of sections 7602, 7603, and 7604 of the Internal Revenue Code with respect to any request to examine records or produce testimony related to the proper treatment of amounts required to be taken into account under the rules of section 6048(b)(1)(A) or to any summons for such records or testimony. I certify that I have the authority to execute this authorization of agent to act on behalf of [name of foreign trust].

---

Signature of \_\_\_\_\_ (title) \_\_\_\_\_ (date)  
trustee (or other  
authorized person)

Type or print your name below

---

TIN (if any)

---

Address

[Name of agent] accepts this appointment to act as agent for [name of foreign trust] for the above purpose. I certify that I have the authority to execute this authorization of agent to act on behalf of [name of foreign trust] and agree to accept service of process for the above purposes

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Signature of agent \_\_\_\_\_ (title) \_\_\_\_\_ (date)

Type or print your name below

---

TIN (if any)

---

Address

The authorization of agent agreement must be executed by the foreign trust and the U.S. agent prior to the due date of the U.S. owner's Form 3520 for the taxable year that he or she is considered the owner of the trust. The authorization must remain in effect for as long as the statute of limitations remains open for the U.S. owner's relevant taxable year. If the agent resigns, liquidates or its responsibility as an agent of the trust is terminated, the U.S. owner of the foreign trust must ensure that the foreign trust notifies the Commissioner within 90 days, by filing an amended Form 3520-A with the Philadelphia Service Center. This notification must contain the name, address and TIN of the new U.S. agent (if any).

A foreign trust will not be treated as having a U.S. agent unless the foreign trust identifies the name, address and taxpayer identification number of the U.S. agent on Form 3520-A. Even if the foreign trust identifies a U.S. agent on Form 3520-A, however, the foreign trust may be treated as providing incorrect information and, therefore, the U.S. owner may be subject to the penalty described in section 6677(a) and (b) if either the U.S. agent or the foreign trust does not comply with its obligations under the agreement (e.g., the foreign trust fails to produce records requested by the Service in reliance on the bank secrecy laws of the country where the trust's bank accounts are located).

## **Section V. U.S. Beneficiaries of Foreign Trusts**

Generally, a U.S. person who receives a distribution, directly or indirectly, from a foreign trust after August 20, 1996, is required to report on Form 3520 the name of the trust, the aggregate amount of distributions received from the trust during the taxable year, and such other information as the Secretary may prescribe. Section 6048(c). Reporting is required under section 6048(c) only if the U.S. person knows or has reason to know that the trust is a foreign trust. A U.S. beneficiary who fails to report a distribution received after August 20, 1996, will be subject to a 35 percent penalty on the gross amount of the distribution. Section 6677(a).

Except as otherwise provided below, a distribution from a foreign trust includes any gratuitous transfer of money or property from a foreign trust, whether or not the trust is owned by another person. A distribution from a foreign trust includes the receipt of trust corpus and the receipt of a gift or bequest described in section 663(a). In addition, a distribution is reportable if it is either actually or constructively received. For example, if a U.S. beneficiary uses a credit card, and charges on that credit card are paid or otherwise satisfied by a foreign trust or guaranteed or secured by the assets of a foreign trust, the amount charged on that credit card will be treated as a distribution to the U.S. beneficiary that must be reported under section 6048(c) for the year in which the charge occurs. If a beneficiary writes a check on the foreign trust's bank or brokerage account or otherwise incurs a debt charged to the foreign trust, the amount incurred will be treated as a distribution to the U.S. beneficiary that must be reported under section 6048(c). Also, if a beneficiary receives a payment from a foreign trust in exchange for property transferred to the trust or services rendered to the trust, and the fair market value of the payment received exceeds the fair market value of the property transferred or services rendered, such excess will be treated as a distribution to the U.S. beneficiary that must be reported under section 6048(c). For example, if a U.S. beneficiary receives a payment from a foreign trust purportedly in exchange for the beneficiary's performance of services as a trustee of the trust, and the payment exceeds the fair market value of the services actually performed by

the beneficiary, the excess will be treated as a distribution to the beneficiary.

The Secretary may suspend or modify any requirement of this section. Section 6048(d)(4). Reporting is not required under section 6048(c) with respect to distributions from trusts that are taxable as compensation for services rendered, within the meaning of section 672(f)(2)(B) and the regulations thereunder, so long as the recipient of a distribution from such a trust reports the distribution as compensation income on its applicable federal income tax return. Section 6048(d)(4). Reporting is also not required under section 6048(c) with respect to distributions from foreign trusts received by domestic organizations described in section 501(c)(3), provided the organization has a determination letter from the Service that has not been revoked recognizing its status as exempt from income taxation under section 501(a).

### **A. Loans to U.S. Grantors and U.S. Beneficiaries**

Section 643(i) provides that, except as provided in regulations, if a foreign trust directly or indirectly makes a loan of cash or marketable securities to a U.S. grantor or U.S. beneficiary of the trust, the amount of the loan will be treated as a distribution to that grantor or beneficiary. If such a loan is made to a U.S. person who is related to a U.S. grantor or U.S. beneficiary (within the meaning of section 643(i)(2)(B)), the amount of the loan will be treated as a distribution to the related grantor or beneficiary. The amount of a loan is its issue price, as determined under § 1.446-2(d)(1), § 1.1273-2 or § 1.1274-2 (whichever is applicable).

For purposes of section 643(i), a loan of cash will be considered to include an extension of credit to a person related to the trust upon the purchase of property from the trust. Sections 643(i) and 643(a)(7); Rev. Rul. 85-13, 1985-1 C.B. 184, 185. If a trust makes a loan to a grantor that causes the grantor to be treated as the owner of a portion of the trust under section 675(3), the loan will not be treated as a distribution under section 643(i), and will not be reportable under section 6048(c).

Congress intended that Treasury and the Service would exercise regulatory authority to create an exception to this treatment for certain loans. In exercising this regulatory authority, Congress expected that Treasury and the Service

would give consideration to whether there is a reasonable expectation that the grantor, beneficiary or related person would repay the loan. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 334 (1996).

This notice announces that regulations will treat such a loan as a distribution unless the loan is in consideration for a "qualified obligation" from the grantor, beneficiary or a related person. An obligation is 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 of the obligation is not less than 100 percent of the applicable Federal rate and not greater than 130 percent of the applicable Federal rate (the applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin);

(v) The U.S. person extends the period for assessment of any income tax attributable to the loan 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 issued in consideration for the loan (this extension is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. person's taxable year and is paid within such period); when properly executed and filed, such an agreement will be deemed to be consented to by the Service Center Director or the Assistant Commissioner (International) for purposes of § 301.6501(c)-1(d); and

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

If, while the original obligation is outstanding, the U.S. grantor or U.S. beneficiary (or a person related to the U.S. grantor or U.S. beneficiary) directly or indirectly issues another obligation to the trust the original obligation will be 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 U.S. grantor or U.S. beneficiary (or a person related to the U.S. grantor or U.S. beneficiary) will be treated as a single obligation of the U.S. grantor or U.S. beneficiary if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of this provision.

If an obligation treated as a qualified obligation subsequently fails to be a qualified obligation (e.g., a renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. grantor or U.S. beneficiary (or related person) will be treated as receiving a distribution from 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 U.S. grantor or U.S. beneficiary (or related person), the amount of the distribution will not exceed the issue price of the subsequent obligation. The subsequent obligation will be separately tested to determine if it is a qualified obligation.

Generally, as discussed above, a distribution resulting from a failed qualified obligation will be 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 facts and circumstances, the district director may deem the distribution 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 district director could deem the distribution to have occurred on the issue date of the original obligation. A demand loan does not have a specified term and, therefore, cannot be a "qualified obligation." In addition, an annuity contract cannot be a "qualified obligation."

Section 643(i) applies to any loan of cash or marketable securities issued by a foreign trust after September 19, 1995, whether or not in accordance with a preexisting arrangement or understanding. For purposes of section 643(i), if an

obligation issued on or before September 19, 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 contained in revised section 6677 will only apply to the failure to report loan in consideration for an obligation issued after August 20, 1996.

## B. Beneficiary Statements.

Section 6048(c)(2) provides that any distribution from a foreign trust, whether from income or corpus, to a U.S. beneficiary will be treated as an accumulation distribution includable in the gross income of the distributee if adequate records are not provided to the Secretary to determine the proper treatment of the distribution. An accumulation distribution from a foreign trust is generally taxed pursuant to sections 665 through 668. Section 668, as amended by the Act, generally imposes an interest charge on distributions of accumulated income at the rate applicable to general underpayments of income tax.

A U.S. beneficiary will not be required to treat the entire distribution as an accumulation distribution if the beneficiary obtains from the foreign trust either a Foreign Grantor Trust Beneficiary Statement (see part 5 of the Foreign Grantor Trust Information Statement as described in Section IV.A. of this notice) or a Foreign Nongrantor Trust Beneficiary Statement (described below) with respect to the distribution. If a U.S. beneficiary cannot obtain such a beneficiary statement from the trust, it is expected that Form 3520 will allow the U.S. beneficiary to avoid treating the entire amount as an accumulation distribution if the U.S. beneficiary can provide certain information regarding actual distributions from the trust for the prior three years. Under this "default treatment," the U.S. beneficiary will be allowed to treat a portion of the distribution as a distribution of current income based on the average of distributions from the prior three years, with only the excess amount of the distribution treated as an accumulation distribution (and therefore subject to the interest charge of section 668). Form 3520 will describe this default treatment option in greater detail. A U.S. beneficiary's use of this default treatment will not affect calculations by the trust (e.g., calculations of the trust's distributable net income under section 643(a)).

To completely avoid default treatment, a beneficiary receiving a distribution from a trust must obtain either a Foreign Grantor Trust Beneficiary Statement or a Foreign Nongrantor Trust Beneficiary Statement with respect to the portion of the trust from which the beneficiary received the distribution. The beneficiary must attach a copy of the relevant beneficiary statement(s) to his or her Form 3520.

If a U.S. beneficiary receives a complete Foreign Grantor Trust Beneficiary Statement with respect to a distribution during the taxable year, the beneficiary should treat the distribution as a gift from the owner of the trust, and therefore, generally as nontaxable. If a U.S. beneficiary receives a complete Foreign Nongrantor Trust Beneficiary Statement that provides adequate information to determine the U.S. tax consequences of the distribution from the foreign trust, the beneficiary may determine the tax consequences of the distribution on an actual basis and avoid the default treatment. The U.S. beneficiary may determine the tax consequences of the distribution in accordance with the information in the beneficiary statement only if the beneficiary has a copy of the relevant beneficiary statement(s) at the time he or she files his or her income tax return. A U.S. beneficiary may not rely on a beneficiary statement if he or she knows or has reason to know that the information contained in the statement is incorrect.

A Foreign Nongrantor Trust Beneficiary Statement must contain the following information and be set forth in substantially the following format:

## FOREIGN NONGRANTOR TRUST BENEFICIARY STATEMENT

1. Foreign Trust Background Information
  - A. Name, address and employer identification number ("EIN") of the trust
  - B. Name, address and taxpayer identification number ("TIN") (if any) of the trustee furnishing this statement
  - C. Method of accounting used by the trust (cash or accrual)
  - D. The taxable year of the foreign trust to which the statement applies
- E. A statement identifying whether any grantor of the trust was a partnership or foreign corporation. If so, attach an explanation of the relevant facts.

2. U.S. Beneficiary Information
  - A. Name, address and TIN of U.S. Beneficiary
  - B. A description of the property (including cash) distributed or deemed distributed to the U.S. person during the taxable year, and the fair market value of the property distributed.
3. Sufficient information to enable the U.S. beneficiary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes. Normally, information similar to the information required by Schedule K-1 of Form 1041 would be adequate for this purpose. If relevant, the trust must also provide the beneficiary with adequate information for the beneficiary to complete Forms 4970, 5471, and 8621.
4. Representation on Access to Books and Records

- A. A statement that, upon request, the trust will permit either the Service or the U.S. beneficiary to inspect and copy the trust's permanent books of account, records, and such other documents that are necessary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes; or
- B. The name, address and EIN of the trust's U.S. agent.

Regarding the procedures for the foreign trust to appoint a U.S. agent, see Section IV.B. of this notice.

## **Section VI. U.S. Recipients of Foreign Gifts.**

The Act creates new reporting requirements under section 6039F for U.S. persons (other than an organization described in section 501(c) and exempt from tax under section 501(a)) that receive large gifts (including bequests) from foreign persons after August 20, 1996. Generally, if the value of the aggregate foreign gifts received by a U.S. person during any taxable year exceeds \$10,000, the U.S. recipient must provide such information as the Secretary prescribes. Section 6039F(a). The term "foreign gift" means any amount received from a person other than a United States person that the recipient treats as a gift or bequest, but does not include any qualified transfer within the meaning of section 2503(e)(2) (relating to certain transfers for educational or

medical expenses) or any distribution properly reported under section 6048(c). Section 6039F(b).

Reporting under section 6039F will be required on an annual basis on Form 3520. It is expected that Form 3520 will only require the reporting of general information necessary to determine whether a purported gift is properly classified as a gift or income. For example, limited information will be required regarding whether the foreign donor is an individual, corporation, partnership, or estate, and whether the foreign donor was acting as a nominee or intermediary for another person. Also, a brief description of the property received will be required. It is expected that the form will not require information on the identity of the foreign donor unless the foreign donor is a partnership or foreign corporation, or is acting as a nominee or intermediary for such an entity. However, the U.S. donee may be required to provide additional information, including the identity of the donor, to the IRS upon request.

If a gift is not reported on Form 3520, the tax consequences of the receipt of the gift shall be determined by the Secretary. Section 6039F(c)(1)(A). In addition, the recipient is subject to a penalty equal to 5 percent of the value of the gift for each month in which the gift is not reported (not to exceed 25 percent). Section 6039F(c)(1)(B). Reporting is only required under section 6039F for gifts actually or constructively received by a U.S. person. Furthermore, reporting is required under section 6039F only if the U.S. person knows or has reason to know that the donor is a foreign person.

### **A. Application of section 6039F to distributions from and contributions to trusts**

If a foreign trust makes a distribution to a U.S. beneficiary, the beneficiary should report the amount as a distribution from the trust under section 6048(c), rather than as a gift under section 6039F. Contributions of property by foreign persons to domestic or foreign trusts that have U.S. beneficiaries are not reportable by the U.S. beneficiaries under section 6039F unless the U.S. persons are treated as receiving the contribution in the year of the transfer (e.g., the beneficiary is an owner of that portion of the trust under section 678). A domestic trust that is not treated as owned by another person is required to report the receipt of a contribution to

the trust from a foreign person as a gift under section 6039F. A domestic trust that is treated as owned by a foreign person is not required to report the receipt of a contribution to the trust from a foreign person. However, a U.S. person should report the receipt of a distribution from such a trust as a gift from a foreign person under section 6039F.

### **B. Reporting thresholds**

For purposes of determining whether the receipt of a gift from a foreign person is reportable, Treasury and the Service have determined that different reporting thresholds are warranted for gifts received from nonresident alien individuals, foreign estates, foreign partnerships, and foreign corporations. Accordingly, it is expected that Form 3520 will apply the following reporting thresholds and requirements:

#### **1. Gifts from foreign individuals and foreign estates.**

A U.S. person is required to report the receipt of gifts from a nonresident alien or foreign estate only if the aggregate amount of gifts from that nonresident alien or foreign estate exceeds \$100,000 during the taxable year. Once the \$100,000 threshold has been met, it is expected that Form 3520 will require the donee to separately identify each gift in excess of \$5,000, but will not require the identification of the donor.

#### **2. Purported gifts from foreign corporations or foreign partnerships**

A U.S. person is required to report the receipt of purported gifts from foreign corporations and foreign partnerships if the aggregate amount of purported gifts from all such entities exceeds \$10,000 (as modified by cost-of-living adjustments under section 6039F(d)) during the taxable year.

Once the \$10,000 threshold has been met, it is expected that Form 3520 will require the donee to separately identify all purported gifts from a foreign corporation or foreign partnership, including the identity of the donor entity. Purported gifts from foreign corporations or foreign partnerships are subject to recharacterization under new section 672(f)(4).

#### **3. Aggregation rules**

To calculate if a U.S. person has received gifts during the taxable year from a particular foreign person in excess of the relevant threshold, the U.S. person must aggregate gifts from foreign persons that he knows or has reason to

know are related, within the meaning of section 643(i)(2)(B), whether or not the gifts from a related person would independently exceed the threshold for reporting of gifts from that person. If the relevant reporting threshold is exceeded, it is expected that Form 3520 will require the donee to separately identify each aggregated gift in excess of \$5,000 from a nonresident alien or foreign estate, but will not require the identification of such a donor, and to separately identify each aggregated purported gift from a foreign corporation or foreign partnership, including the identity of the donor entity.

*Example 14. Gifts from related foreign individuals.* A is a U.S. citizen who is married to B. B and all of B's brothers, C, D, and E, are not U.S. persons. In a single taxable year, B makes a gift of \$90,000 to A, C makes a gift of \$40,000 to A, D makes two gifts to A (one of \$4,000 and one of \$3,000), and E makes a gift of \$4,000 to A. For that taxable year, A must report the receipt of \$141,000 in gifts from foreign persons. A must separately identify the \$90,000 gift from B, because B and his brothers gave gifts in excess of \$100,000. A must also separately identify the \$40,000 gift from C, because C and his brothers gave gifts in excess of \$100,000. A must identify the receipt of \$7,000 in total gifts from D because D and his brothers gave gifts in excess of \$100,000, but is not required to separately list information about each transaction because no gift is in excess of \$5,000. A is not required to separately identify transaction information about E's gifts, because gifts from foreign individuals of less than \$5,000 are not required to be separately identified. Because B, C, and D are individuals, A need not identify these donors when reporting the transactions.

*Example 15. Gifts from related foreign individual and corporation.* A is a U.S. citizen who is married to B. B is the sole shareholder of FC, a foreign corporation. B is not a U.S. person. In a taxable year, B makes a gift of \$6,000 to A, and FC makes a purported gift of \$8,000 to A. Because A knows or has reason to know that B and FC are related, A must aggregate gifts from B and FC (\$14,000). Although the \$14,000 aggregate amount deemed received from B does not exceed the \$100,000 threshold with respect to gifts from nonresident aliens, the \$14,000 aggregate amount deemed received from FC exceeds the \$10,000 threshold with respect to gifts from foreign corporations. Accordingly, A must separately identify each gift from B and FC, and must provide identifying information about FC because it is a foreign corporation.

## Section VII. Penalties for Failure to Provide Information

Substantial penalties under section 6677 and 6039F(c) apply if information required by section 6048 or section 6039F is not reported or is reported inaccurately. Generally, the penalty depends on the "gross value" or "gross amount" of the property involved.

In determining the gross value or gross amount of property, the valuation principles of section 2512 and the regulations thereunder must be used, without regard to any prohibitions or restrictions on a person's interest in the property.

Penalties under sections 6677(a) and 6039F will not be imposed if the failure to file was due to reasonable cause and not willful neglect. A taxpayer will not have reasonable cause merely because a foreign country would impose a civil or criminal penalty on the trustee (or other person) for disclosing the required information. Section 6677(d). Also, refusal on the part of a foreign trustee to provide information for any other reason, including difficulty in producing the required information or provisions in the trust instrument that prevent the disclosure of required information, will not be considered reasonable cause.

The penalties under section 6677 apply only to the extent that the transaction is not reported or is reported inaccurately. Thus, if a U.S. person transfers property worth \$1,000,000 to a foreign trust, but reports only \$400,000 of that amount, penalties may be imposed only on the unreported \$600,000.

Moreover, if the penalties under both sections 6677 and 1494(c) could apply to the failure to report the transfer of property to a foreign trust, the penalty under section 6677 will be assessed and will reduce any penalty otherwise imposed under section 1494(c).

If the penalties under both sections 6039F and section 6677 could apply to the failure to report a distribution from a foreign trust treated as a gift, the penalty under section 6677 will be assessed, and will reduce any penalty otherwise imposed under section 6039F.

## Section VIII. Transition Rules

### A. Filing dates

Generally, to avoid penalties under sections 1494(c), 6039F, or 6677, Form 3520 must be filed as an attachment to the taxpayer's income tax return by the due date (including extensions) of the taxpayer's income tax return. In addition, unless otherwise provided, a copy of Form 3520 must be sent to the Philadelphia Service Center by the same date. However, with respect to Form 3520 for the taxable year that includes August 20, 1996 (the "1996 Form 3520"), no such penalties will be imposed if the taxpayer files the 1996 Form 3520 on or before November 15, 1997, with the Philadelphia Service

Center. Alternatively, no section 1494(c), 6039F, or 6677 penalties will be imposed for a failure to file Form 3520 if the taxpayer files the 1996 Form 3520 by the due date (including extensions) for the taxpayer's income tax return for the first taxable year beginning on or after January 1, 1997, provided the taxpayer's income tax return for the tax year that includes August 20, 1996, reflects the information contained in the 1996 Form 3520. Taxpayers who file a Form 3520 that is not revised as described herein will not be considered to have complied with the information reporting requirements of revised sections 1494 and 6048.

Generally, no section 6677 penalty will be assessed on the U.S. owner of a foreign trust for a failure to file Form 3520-A if the foreign trust files Form 3520-A with the Philadelphia Service Center by the fifteenth day of the third month following the end of the trust's taxable year (or later, if pursuant to an extension of time to file). However, with respect to Form 3520-A for the taxable year that includes August 20, 1996 (the "1996 Form 3520-A"), no such penalty will be imposed if the foreign trust files the 1996 Form 3520-A on or before October 15, 1997. Alternatively, no section 6677 penalty will be imposed if the foreign trust files the 1996 Form 3520-A by the due date (including extensions) for the Form 3520-A for the first taxable year beginning on or after January 1, 1997, provided the U.S. owner reflects the information contained in the 1996 Form 3520-A on the owner's income tax return for the tax year that includes August 20, 1996.

*Example 16. Time to report receipt of 1996 trust distributions.* A, a U.S. citizen whose taxable year is the calendar year, receives a distribution from a foreign trust on November 1, 1996. A reports the distribution as ordinary income (without an interest charge under section 668) on his 1996 income tax return, which is filed on June 15, 1997. No section 6677 penalty will be imposed if A files a 1996 Form 3520 by November 15, 1997. Alternatively, A will be allowed to delay filing his 1996 Form 3520 until he files his 1997 income tax return (by April 15, 1998, or a later date if the date for filing the return is extended), but only if A reflects the correct information contained in the Form 3520 on his 1996 income tax return. Thus, if the 1996 Form 3520 indicates that the distribution should be treated as ordinary income without an interest charge under section 668, A may file the 1996 Form 3520 by April 15, 1998, and need not amend his 1996 income tax return. However, if the Form 3520 indicates that the distribution is subject to an interest charge under section 668, and A files the 1996 Form 3520 on April 15, 1998, A will be liable

for the section 6677 penalty unless A also amends his 1996 income tax return to reflect the interest charge.

## B. Interaction with Notice 96-65

As described in Notice 96-65, 1996-52 I.R.B. 28, the Act amended section 7701(a)(30) and (31) to set forth new criteria that must be met for a trust to qualify as a domestic trust. Certain domestic trusts will be treated as making section 1491 transfers on January 1, 1997, as a result of becoming foreign trusts under the new law. If a domestic trust relies in good faith on Notice 96-65 to continue to file tax returns as a domestic trust, but is unable to meet the new domestic trust criteria by the end of the two-year period set forth in the notice, no U.S. person (transferor, owner, or beneficiary) will be required to treat the trust as a foreign trust and thereby report transfers to or distributions from that trust on Form 3520 during the two-year period. Further, the trust will not be required to file Form 3520-A for that two-year period. Finally, no penalty will be imposed under sections 1494(c), 6039F, or 6677 for failure to report transactions with the trust during that period, or for the trust failing to file Form 3520-A for that period. However, if the trust has not successfully met the new domestic trust criteria by the expiration of the two-year period, penalties under sections 1494(c), 6039F, or 6677 will be imposed unless the relevant Forms 3520 and 3520-A reporting all transactions during that two-year period are filed within 90 days after the expiration of the two-year period.

## C. Domestic Trusts with Foreign Activities

Section 6048(d)(2) provides that, to the extent provided in regulations, a domestic trust may be treated as a foreign trust for purposes of sections 6048 and 6677 if the trust has substantial activities, or holds substantial property, outside the United States. Treasury and the Service are studying the appropriate scope of section 6048(d)(2). Until further guidance is issued, domestic trusts will not be treated as foreign trusts pursuant to that section.

## EFFECT ON OTHER GUIDANCE

Section II.B.4. of Notice 97-18, 1997-10 I.R.B. 35, which provides that a U.S. person who makes a transfer to a foreign trust may satisfy that person's reporting requirements under section 1494 solely by complying with the reporting requirements of section 6048(a), is hereby modified.

## PUBLIC COMMENT INVITED

Treasury and the Service invite comments on the guidance provided by this notice. Written comments should be submitted by August 1, 1997 to:

Internal Revenue Service  
P.O. Box 7604  
Ben Franklin Station  
Attention: CC:CORP:T:R:  
(Notice 97-34)  
Room 5228  
Washington, DC 20044  
or, alternatively, via the internet at:  
<http://www.irs.ustreas.gov/prod/taxregs/comments.html>.

The comments submitted will be available for public inspection and copying.

## PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget for review in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1538.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this notice are in the sections III, IV, V, and VI. This information is required by the IRS to assure compliance with the new provisions of the Small Business Job Protection Act of 1996. The likely respondents are individuals, business or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting burden is 11,000 hours. The estimated average annual burden per respondent varies from .50 hours to 2 hours, de-

pending on individual circumstances, with an estimated average of 1 hour and 3 minutes. The estimated number of respondents is 10,500. The estimated annual frequency of responses is annually.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## DRAFTING INFORMATION

The principal author of this notice is Leslie Cracraft, formerly of the Office of Associate Chief Counsel (International). For further information regarding sections 1491, 1494, 6039F, 6048 and 6677, contact Michael Kirsch on (202) 622-3860. For further information on section 679, contact Willard Yates on (202) 622-3870. For further information regarding sections 7701(a)(30) and (31), contact James Quinn on (202) 622-3060. For further information regarding section 672(f), contact Grace Fleeman on (202) 622-3850. These contact numbers are not toll-free calls.

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## Weighted Average Interest Rate Update

### Notice 97-35

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103-465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for May 1997 is 6.94 percent.

The following rates were determined for the plan years beginning in the month shown on next page.

Month	Year	Weighted Average	90% to 107% Permissible Range	90% to 110% Permissible Range
June	1997	6.87	6.18 to 7.35	6.18 to 7.56

Drafting Information

The principal author of this notice is Donna Prestia of the Employee Plans

Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 4:00 p.m. Eastern time (not a toll-free number). Ms. Prestia's number is (202) 622-7377 (also not a toll-free number).

## Part IV. Items of General Interest

### Foundations Status of Certain Organizations

#### Announcement 97-62

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

*Former Public Charities.* The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Academy of Sacred Music, Washington, DC  
American International Health Alliance, Inc., Washington, DC  
Apalachee Bay Volunteer Fire Department, Inc., Crawfordville, FL  
Arts and Crafts Guild of Macon County, Inc., Lafayette, TN  
Asociacion De Vecinos Para Servicios Para Socorro T.U., El Paso, TX  
Atlanta Area Deming Study Group Inc., Chamblee, GA  
Catholic Faith Alive Inc., Silver Spring, MD  
Clean Florida Keys Inc., Key West, FL  
Cross of Christ Ministries Inc., Tulsa, OK  
Belmont Rotary Senior Housing Program, Inc., Belmont, CA  
Better Living All Concerned, Los Angeles, CA  
Brisbane Educational Support Team, Brisbane, CA  
Calabasas Residential Treatment Center, West Hills, CA  
Central Health Initiative Inc., Mt. Pleasant, MI  
Colorado Consortium for Experiential Education, Greeley, CO

Columbia River Institute, Portland, OR  
Columbia Valley Gardens PTA, Tacoma, WA  
Columbia Youth Soccer Association, Inc., Lake City, FL  
Columbus Grove Gift Corporation, Tucson, AZ  
Common Ground, Charlotte, NC  
Common Ground Ministries, Waxahachie, TX  
Commonwealth of Independent States American Alliance, Inc., Highland Park, IL  
Esther Ministries Eternally Settled Through Honoring Every Righteous, Philadelphia, PA  
Forum for a Common Agenda, Reno, NV  
Friends for Excellence in Education, Mendocino, CA  
Friends of Albuquerque Gymnastics, Albuquerque, NM  
Friends of Al Pi Darko Charitable Trust, Brooklyn, NY  
Friends of Blanches Park, San Francisco, CA  
Friends of Brown Band, Inc., New York, NY  
Friends of Mental Health, El Centro, CA  
Friends of Petrified Sea Gardens, Saratoga Springs, NY  
House of Prayer Ministries Inc., Lake Placid, FL  
Housing and Services, Bangor, ME  
International Institute of Molecular Physiology, Inc., Cambridge, MA  
International Sisterhood, Los Angeles, CA  
Lincoln-Woodstock Housing Opportunities, Inc., N. Woodstock, NH  
Maclarens Foundation, Marblehead, MA  
Majority Peoples Fund, New York, NY  
Malta Human Services Foundation, New York, NY  
Mariachi O, Alhambra, CA  
North Side Family Center, St. Louis, MO  
Ocean-Five Cities Swimming Pool Foundation, Oceano, CA  
Oregon Area General Service Assembly of AA, Bend, OR  
Parent Teacher Student Organization of Mountain View Elementary School, Shelton, WA  
Rose Marie Wameling Ministries, Inc., Tulsa, OK  
Rotary Club of Carbondale, Carbondale, IL  
Rotary Club of Central Marin Foundation, Ross, CA  
Rotary Foundation of Lake Forest, Irvine, CA  
Santas Cause, Oak View, CA  
Shelter Institute of America, Springfield, IL  
Special Activities Unit for the Aged, Columbus, OH  
Strongsville High School Swim Team Boosters, Strongsville, OH  
Student Parent Support Services Corp., Schenevus, NY  
United Dyslexia Association, Elko, NV  
University City Development Corp., Detroit, MI  
Veterans Care Project of Calif., Inc., Grand Terrace, CA  
Vinita Senior Citizens Center, Vinita, OK  
Visions for Youth, Santa Rosa, CA  
Vista Educational Media, Redondo Beach, CA  
Western North Carolina Sports Inc., Asheville, NC  
West Lane Baseball Association, Florence, OR

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

# **Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service**

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Rev-

enue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public

accountant, enrolled agent, or enrolled actuary and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Bert Jr., Earol L.	Severna Park, MD	CPA	February 1, 1997 to July 31, 1997
Bernard, Lucius P.	Corte Medera, CA	Attorney	March 10, 1997 to March 9, 2000
Parker, David A.	Willmar, MN	CPA	April 13, 1997 to April 12, 2000
Sheldon, Donald	Nashville, TN	CPA	April 24, 1997 to September 23, 1997
Grandt, Lawrence E.	Barrington, IL	CPA	April 24, 1997 to January 23, 1998
Reese, Rex E.	Alexandria, VA	Attorney	May 1, 1997 to April 30, 1999
Glasl, John E.	Emporium, PA	CPA	May 1, 1997 to September 30, 1997
Coulter, Diane E.	Monroeville, PA	CPA	May 1, 1997 to April 30, 1998
Groves, J. Randall	Matthews, NC	Attorney	May 1, 1997 to October 31, 1998
Lupiloff, Steven	Bloomfield, MI	Attorney	Indefinite from May 6, 1997
Wilson, Robert L.	Spring Hill, FL	CPA	May 7, 1997 to October 6, 1998
Sloop, Wayne F.	Winston-Salem, NC	CPA	Indefinite from May 7, 1997
Wilnewic, Mark V.	Crystal Lake, IL	CPA	May 8, 1997 to November 7, 1997
Lenihan, Michael	Cincinnati, OH	CPA	May 14, 1997 to July 13, 1997
Bergmann, Frederick	Tampa, FL	CPA	June 1, 1997 to May 30, 1999
Farmer, Craig	Arlington Hghts, IL	CPA	June 1, 1997 to August 31, 1997
Denny, Richard	Pine Bluff, AR	CPA	June 1, 1997 to July 31, 1997

# **Announcement of the Expedited Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service**

Under title 31 of the Code of Federal Regulations, section 10.76, the Director of Practice is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years, from the date the expedited proceeding is instituted, (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause; or (2) has been convicted of any crime under title 26 of the United States Code or, of a felony under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents, and enrolled actu-

aries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under expedited suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public

accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions of the applicable regulations:

Name	Address	Designation	Date of Suspension
Dally, Candace L.	Winston-Salem, NC	CPA	Indefinite from April 16, 1997
Mellor, Gary D.	Norton, KS	Attorney	Indefinite from April 16, 1997
Gottesman, Milton	New York, NY	CPA	Indefinite from April 16, 1997
Wiener, James	Germantown, NY	Attorney	Indefinite from April 16, 1997
Lunblad, Gerald	Sacramento, CA	CPA	Indefinite from April 16, 1997
Driscoll, Robert J.	Denver, CO	Attorney	Indefinite from April 16, 1997
Alico, Kenneth N.	Orchard Park, NY	CPA	Indefinite from April 16, 1997
Mack, Roland G.	Hyattsville, MD	CPA	Indefinite from May 1, 1997

## 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 Contribution 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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<sup>1</sup>A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1996–27 through 1996–53 will be found in Internal Revenue Bulletin 1997–1, dated January 6, 1997.

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