

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others As Substantial Owners

26 CFR 1.671-2: Applicable principles.

T.D. 8890

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Definition of Grantor

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations defining the term *grantor* for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code. These regulations provide necessary guidance in determining who is the grantor of a trust in applying those Code sections. These regulations affect trusts and any person creating or funding a trust.

DATES: *Effective Date:* These regulations are effective July 5, 2000.

Applicability Dates: For dates of applicability of §1.671-2(e), see §1.671-2(e)(7).

FOR FURTHER INFORMATION CONTACT: James A. Quinn at (202) 622-3060 (not a toll-free number).

SUPPLEMENTARY INFORMATION

Background

On June 5, 1997, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-252487-96, 1997-1 C.B. 806) under section 671 of the Internal Revenue Code (Code) in the **Federal Register** (62 F.R. 30785). Comments responding to the notice were received and a public hearing was held on August 27, 1997. After consideration of the comments, the proposed regulations under section 671 were re-issued as proposed (64 F.R. 43323) and temporary regulations (64 F.R. 43267) on August 10, 1999.

The proposed and temporary regulations provide a definition of grantor for purposes of part I of subchapter J, chapter 1 of the Code. No comments were received in response to the Notice of Proposed Rulemaking published on August 10, 1999, in the **Federal Register**, and no one requested to speak at the public hearing scheduled for November 2, 1999. Accordingly, the public hearing was canceled on October 28, 1999 (64 F.R. 58006). This document finalizes the proposed regulations and removes the temporary regulations.

Special Analyses

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

Drafting Information

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

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for section 1.671-2T and adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.671-2 also issued under 26 U.S.C. 643(a)(7) and 672(f)(6). * * *

§1.643(h)-1 [Amended]

Par. 2. Section 1.643(h)-1 is amended as follows:

1. In paragraph (a)(2)(i) the language “§1.671-2T(e)(2)” is removed, and “§1.671-2(e)(2)” is added in its place.

2. In paragraph (b)(1) the language “§1.671-2T(e)(2)” is removed, and “§1.671-2(e)(2)” is added in its place.

3. In paragraph (b)(2) the language “§1.671-2T(e)” is removed, and “§1.671-2(e)” is added in its place.

4. In paragraph (g) *Example 1* the language “§1.671-2T(e)(2)” is removed, and “§1.671-2(e)(2)” is added in its place.

Par. 3. Section 1.671-2(e) is revised to read as follows:

§1.671-2 *Applicable principles.*

* * * * *

(e)(1) For purposes of part I of subchapter J, chapter 1 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)(2) of this section) of property to a trust. For purposes of this section, the term *property* includes cash. If a person creates or funds a trust on behalf of another person, both persons are treated as grantors of the trust. (See section 6048 for reporting requirements that apply to grantors of foreign trusts.) However, a person who creates a trust but makes no gratuitous transfers to the trust is not treated as an owner of any portion of the trust under sections 671 through 677 or 679. Also, a person who funds a trust with an amount that is directly reimbursed to such person within a reasonable period of time and who makes no other transfers to the trust that constitute gratuitous transfers is not treated as an owner of any portion of the trust under sections 671 through 677 or 679. See also §1.672(f)-5(a).

(2)(i) A gratuitous transfer is any transfer other than a transfer for fair market value. A transfer of property to a trust may be considered a gratuitous transfer

without regard to whether the transfer is treated as a gift for gift tax purposes.

(ii) For purposes of this paragraph (e), a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust. For example, rents, royalties, interest, and compensation paid to a trust are transfers for fair market value only to the extent that the payments reflect an arm's length price for the use of the property of, or for the services rendered by, the trust. For purposes of this determination, an interest in the trust is not property received from the trust. In addition, a person will not be treated as making a transfer for fair market value merely because the transferor recognizes gain on the transaction. See, for example, section 684 regarding the recognition of gain on certain transfers to foreign trusts.

(iii) For purposes of this paragraph (e), a gratuitous transfer does not include a distribution to a trust with respect to an interest held by such trust in either a trust described in paragraph (e)(3) of this section or an entity other than a trust. For example, a distribution to a trust by a corporation with respect to its stock described in section 301 is not a gratuitous transfer.

(3) A grantor includes any person who acquires an interest in a trust from a grantor of the trust if the interest acquired is an interest in certain investment trusts described in §301.7701-4(c) of this chapter, liquidating trusts described in §301.7701-4(d) of this chapter, or environmental remediation trusts described in §301.7701-4(e) of this chapter.

(4) If a gratuitous transfer is made by a partnership or corporation to a trust and is for a business purpose of the partnership or corporation, the partnership or corporation will generally be treated as the grantor of the trust. For example, if a partnership makes a gratuitous transfer to a trust in order to secure a legal obligation of the partnership to a third party unrelated to the partnership, the partnership will be treated as the grantor of the trust. However, if a partnership or a corporation makes a gratuitous transfer to a trust that is not for a business purpose of the partnership or corporation but is for the personal purposes of one or more of the partners or shareholders, the gratuitous transfer will be treated as a constructive distribution to such part-

ners or shareholders under federal tax principles and the partners or the shareholders will be treated as the grantors of the trust. For example, if a partnership makes a gratuitous transfer to a trust that is for the benefit of a child of a partner, the gratuitous transfer will be treated as a distribution to the partner under section 731 and a subsequent gratuitous transfer by the partner to the trust.

(5) If a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust. However, if a person with a general power of appointment over the transferor trust exercises that power in favor of another trust, then such person will be treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code.

(6) The following examples illustrate the rules of this paragraph (e). Unless otherwise indicated, all trusts are domestic trusts, and all other persons are United States persons. The examples are as follows:

Example 1. A creates and funds a trust, T, for the benefit of her children. B subsequently makes a gratuitous transfer to T. Under paragraph (e)(1) of this section, both A and B are grantors 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. A is a grantor of T. B subsequently acquires A's entire interest in T. Under paragraph (e)(3) of this section, B is a grantor of T with respect to such interest.

Example 3. A, an attorney, creates a foreign trust, FT, on behalf of A's client, B, and transfers \$100 to FT out of A's funds. A is reimbursed by B for the \$100 transferred to FT. The trust instrument states that the trustee has discretion to distribute the income or corpus of FT to B and B's children. Both A and B are treated as grantors of FT under paragraph (e)(1) of this section. In addition, B is treated as the owner of the entire trust under section 677. Because A is reimbursed for the \$100 transferred to FT on behalf of B, A is not treated as transferring any property to FT. Therefore, A is not an owner of any portion of FT under sections 671 through 677 regardless of whether A retained any power over or interest in FT described in sections 673 through 677. Furthermore, A is not treated as an owner of any portion of FT under section 679. Both A and B are responsible parties for purposes of the requirements in section 6048.

Example 4. A creates and funds a trust, T. A does not retain any power or interest in T that would cause A to be treated as an owner of any portion of the trust under sections 671 through 677. B holds an unrestricted power, exercisable solely by B, to withdraw certain amounts contributed to the trust before

the end of the calendar year and to vest those amounts in B. B is treated as an owner of the portion of T that is subject to the withdrawal power under section 678(a)(1). However, B is not a grantor of T under paragraph (e)(1) of this section because B neither created T nor made a gratuitous transfer to T.

Example 5. A transfers cash to a trust, T, through a broker, in exchange for units in T. The units in T are not property for purposes of determining whether A has received fair market value under paragraph (e)(2)(ii) 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, a trust. A has not made any gratuitous transfers to T. Arm's length interest payments by A to T will not be treated as gratuitous transfers under paragraph (e)(2)(ii) 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, B's brother, creates a trust, T, for B's benefit and transfers \$50,000 to T. The trustee invests the \$50,000 in stock of Company X. C, B's uncle, purportedly sells property with a fair market value of \$1,000,000 to T in exchange for the stock when it has appreciated to a fair market value of \$100,000. Under paragraph (e)(2)(ii) of this section, the \$900,000 excess value is a gratuitous transfer by C. Therefore, under paragraph (e)(1) of this section, A is a grantor with respect to the portion of the trust valued at \$100,000, and C is a grantor of T with respect to the portion of the trust valued at \$900,000. In addition, A or C or both will be treated as the owners of the respective portions of the trust of which each person is a grantor if A or C or both retain powers over or interests in such portions under sections 673 through 677.

Example 8. G creates and funds a trust, T1, for the benefit of G's children and grandchildren. After G's death, under authority granted to the trustees in the trust instrument, the trustees of T1 transfer a portion of the assets of T1 to another trust, T2, and retain a power to revoke T2 and revest the assets of T2 in T1. Under paragraphs (e)(1) and (5) of this section, G is the grantor of T1 and T2. In addition, because the trustees of T1 have retained a power to revest the assets of T2 in T1, T1 is treated as the owner of T2 under section 678(a).

Example 9. G creates and funds a trust, T1, for the benefit of B. G retains a power to revest the assets of T1 in G within the meaning of section 676. Under the trust agreement, B is given a general power of appointment over the assets of T1. B exercises the general power of appointment with respect to one-half of the corpus of T1 in favor of a trust, T2, that is for the benefit of C, B's child. Under paragraph (e)(1) of this section, G is the grantor of T1, and under paragraphs (e)(1) and (5) of this section, B is the grantor of T2.

(7) The rules of this section are applicable to any transfer to a trust, or transfer of an interest in a trust, on or after August 10, 1999.

§1.671-2T [Removed]

Par. 4. Section 1.671-2T is removed.

§1.672(f)–2 [Amended]

Approved June 28, 2000.

Par. 5. Section 1.672(f)–2 is amended as follows:

1. In paragraph (b)(1) the language “§1.671–2T(e)(2)” is removed, and “§1.671–2(e)(2)” is added in its place.

2. In paragraph (d) *Example 1* the language “§1.671–2T(e)” is removed, and “§1.671–2(e)” is added in its place.

§1.672(f)–3 [Amended]

Par. 6. Section 1.672(f)–3 is amended as follows:

1. In paragraph (a)(1) the language “§1.671–2T(e)” is removed, and “§1.671–2(e)” is added in its place.

2. In paragraph (a)(4) *Example 2* the language “§1.671–2T(e)” is removed, and “§1.671–2(e)” is added in its place.

3. In paragraph (b)(1) the language “§1.671–2T(e)(2)” is removed, and “§1.671–2(e)(2)” is added in its place.

4. In paragraph (b)(1) the language “§1.671–2T(e)” is removed, and “§1.671–2(e)” is added in its place.

5. In paragraph (b)(4) *Example 1* the language “§1.671–2T(e)” is removed, and “§1.671–2(e)” is added in its place.

6. In paragraph (b)(4) *Example 2* the language “§1.671–2T(e)” is removed and “§1.671–2(e)” is added in its place.

§1.672(f)–4 [Amended]

Par. 7. Section 1.672(f)–4 is amended as follows:

1. In paragraph (c)(1) the language “§1.671–2T(e)(2)” is removed, and “§1.671–2(e)(2)” is added in its place.

2. In paragraph (c)(1) the language “§1.671–2T(e)(4)” is removed, and “§1.671–2(e)(4)” is added in its place.

3. In paragraph (d)(1) the language “§1.671–2T(e)(2)(ii)” is removed, and “§1.671–2(e)(2)(ii)” is added in its place.

4. In paragraph (g) *Example 4* the language “§1.671–2T(e)” is removed, and “§1.671–2(e)” is added in its place.

§1.672(f)–5 [Amended]

Par. 8. In §1.672(f)–5, paragraph (a)(1) is amended by removing the language “§1.671–2T(e)(2)” and adding “§1.671–2(e)(2)” in its place.

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of the Treasury.*

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