

Crummey Trusts: Irrevocable Life Insurance Trusts, Beneficiary Powers, and Notification Requirements

THURSDAY, JULY 23, 2020, 1:00-2:50 pm Eastern

IMPORTANT INFORMATION FOR THE LIVE PROGRAM

This program is approved for 2 CPE credit hours. To earn credit you must:

- **Participate in the program on your own computer connection (no sharing)** - if you need to register additional people, please call customer service at 1-800-926-7926 ext. 1 (or 404-881-1141 ext. 1). Strafford accepts American Express, Visa, MasterCard, Discover.
- Listen on-line via your computer speakers.
- Respond to five prompts during the program plus a single verification code.
- To earn full credit, you must remain connected for the entire program.

WHO TO CONTACT DURING THE LIVE PROGRAM

For Additional Registrations:

-Call Strafford Customer Service 1-800-926-7926 x1 (or 404-881-1141 x1)

For Assistance During the Live Program:

-On the web, use the chat box at the bottom left of the screen

If you get disconnected during the program, you can simply log in using your original instructions and PIN.

ARTICLE I Crummey Rights of Withdrawal: Rules, Limitations and Procedures

The withdrawal rights created in the Article entitled “Crummey Rights of Withdrawal” shall be subject to the rules, limitations and procedures contained in this Article.

A. Withdrawal Rights of Wife. My Wife shall have a right of withdrawal over an amount equal to the value of all contributions to the trust, subject to the limitations set forth below.

1. The maximum amount that my Wife may withdraw with respect to all contributions made in any calendar year shall not, in any event, exceed the lesser of: (i) the Federal gift tax annual exclusion in effect at the time of each contribution, less the amount of prior gifts to my Wife either outright or in trust, by the same donor during the same calendar year, which gifts were eligible for the Federal gift tax annual exclusion but not eligible for the Federal gift tax marital deduction; and (ii) the greater of that amount referred to in Code Sec. 2514(e)(1) (currently, Five Thousand Dollars (\$5,000)) or that percentage referred to in Code Sec. 2514(e)(2) (currently, Five Percent (5%)) of the trust corpus out of which, or the proceeds of which, the exercise of this withdrawal right could be satisfied.

2. The amount withdrawable by my Wife shall be noncumulative and shall lapse sixty (60) days after the contribution was made.

3. My Wife’s withdrawal right continues until it lapses. My Wife’s withdrawal right shall not terminate merely because of the termination of the Grantor Trust, but shall continue with respect to all trusts under this Agreement until it lapses as described above. My Wife’s withdrawal right shall, upon termination of the Grantor Trust, be exercisable first out of that portion of the Trust Fund that qualifies for the Federal estate tax marital deduction.

4. All other withdrawal rights granted under this Article shall be determined with respect to the difference between the value of the contribution to the trust

and any amount that my Wife could withdraw under this section as of the time of the contribution, even if my Wife does not withdraw such amounts.

B. Withdrawal Rights of Descendants. Subject to the limitations set forth below, each of my descendants (herein defined as “holders”) shall have a right of withdrawal over an amount equal to the value of such holder’s proportionate share of the Descendants’ Withdrawal Amount. Such holder’s “proportionate share” shall be determined by dividing the Descendants’ Withdrawal Amount by the number of the then-living holders (not including any individual or individuals excluded as provided below). The “Descendants’ Withdrawal Amount” shall be an amount equal to all contributions made to the trust in any calendar year minus the amount over which my Wife has a right of withdrawal.

1. The maximum amount that a holder may withdraw with respect to all contributions made in any calendar year shall not, in any event, exceed the gift tax annual exclusion in effect at the time of each contribution, less the amount of prior gifts to the same holder either outright or in trust, by the same donor during the same calendar year, which gifts were eligible for the Federal gift tax annual exclusion.

2. The amount withdrawable by any holder shall be cumulative, and shall lapse on the last day of each calendar year in an amount equal to the greater of that sum referred to in Code Sec. 2514(e)(1) (currently, Five Thousand Dollars (\$5,000)) or that percentage referred to in Code Sec. 2514(e)(2) (currently, Five Percent (5%)) of the trust corpus out of which, or the proceeds of which, the exercise of this withdrawal right could be satisfied. Rights of withdrawal that do not lapse at the end of a calendar year shall continue to be exercisable by the holder subject to this same limited annual lapse.

3. Withdrawal rights exercisable by a holder under this section respecting a contribution made fewer than thirty (30) days before the end of a calendar year shall not lapse at the end of that calendar year but shall remain exercisable by the holder until the end of the next calendar year and notwithstanding any other provision of this section.

4. The withdrawal right of each of the holders shall continue until it lapses as described above and shall not terminate merely because of the termination of the Grantor Trust but shall continue with respect to all trusts under this Agreement except as to any disposition to the Marital Trust of any trust property that is included in my gross estate.

C. Notice. The Trustees shall promptly notify each competent adult who holds a withdrawal right under this Article of all contributions to which that person's withdrawal right relates. The Trustees shall notify a person who is under a legal disability, including (but not limited to) minority, by notifying:

1. the legal guardian or conservator of the individual's property, who is hereby authorized to exercise the withdrawal rights;
2. any living parent of the individual (excluding, however, with respect to any child of mine, both me and any parent of the child who is not then married to me);
3. any other person taking care of the individual or with whom the individual resides; or
4. any other appropriate adult individual selected by the Trustees.

D. Exercise of Withdrawal Right. Withdrawal rights under this Article shall be exercisable by a writing delivered to the Trustees. The person to whom notice is properly given for a minor or disabled individual may decide whether to exercise that minor or disabled individual's withdrawal right, unless that person receiving notice is the donor of the contribution to which the withdrawal right relates, in which case the Trustees shall designate another appropriate adult individual to make such decision.

E. Satisfaction of Withdrawal Right. A withdrawal under this Article may be satisfied from the contribution itself or from other trust assets, as the Trustees shall choose. The principal of any GST Non-Exempt Trust must be exhausted in satisfying a withdrawal right before the principal of any GST-Exempt Trust may be used to satisfy a withdrawal right. A distribution under this Article may be made to the person who makes the withdrawal or who is, under this Article, entitled to act for the minor or disabled individual.

F. Power to Exclude. Any donor may, by an instrument in writing executed before a contribution, exclude one or more individuals from having withdrawal rights over that contribution or any future contribution or both. However, no donor may limit or alter any rights resulting from prior contributions.

G. Power to Amend. The Trustees may, by an instrument in writing, amend this Article to the extent the Trustees shall deem it appropriate to assure that contributions to this trust qualify for the gift tax annual exclusion for Federal gift tax purposes. The Trustees may not amend the trust in any manner that would cause any portion of the trust funds to be included in my gross estate, that of my Wife, or that of any of my descendants, to a greater extent than before such amendment. An amendment made in good faith shall be conclusive on all persons interested in the trust and the Trustees shall not be liable for the consequences of any amendment or for not having amended the trust. No amendment shall limit or alter the rights of a beneficiary in any trust funds held by the Trustees before the amendment. No Interested Trustee or Insured Trustee may participate in any action under this paragraph.

H. Priority of Withdrawal Rights. No Trustee may make any discretionary distributions of principal or income that would reduce the available trust principal below the total amount of the then-existing withdrawal rights without advance notice to each trust beneficiary who is entitled to make a withdrawal, or who is, under this Article, entitled to act for a minor or disabled beneficiary.

I. Special Definitions and Rules. The following definitions and rules apply for purposes of this Article:

1. “Contribution” means any cash or other assets transferred to the Trustees to be held as part of the trust funds, in a manner that constitutes a gift for Federal gift tax purposes. A contribution also includes any direct or indirect payment of the premiums on a policy of insurance held by the Trustees to the extent it constitutes a gift for Federal gift tax purposes. The amount of a contribution is its Federal gift tax value.

2. The amounts involved in a power to withdraw described as “an amount equal to the greater of that sum referred to in Code Sec. 2514(e)(1) (currently, Five

Thousand Dollars (\$5,000)) or that percentage referred to in Code Sec. 2514(e)(2) (currently, Five Percent (5%)) of the trust corpus” shall be measured after subtracting all other amounts that the same person could have withdrawn during the same calendar year from this or any other fund, to the extent that such powers must, under applicable Federal gift tax law, be aggregated in determining whether the lapse of the withdrawal power under this Article is a release of a general power of appointment.

3. If the Trustees shall incorrectly determine the amount that should be distributed to a beneficiary under this Article, then within a reasonable period after the correct amount is finally determined, the Trustees shall receive from the beneficiary, or the beneficiary shall receive from the Trustees, as the case may be, an amount equal to the difference between the amount that should properly have been distributed and the amount actually distributed.

4. All withdrawal rights with respect to a contribution to which this Article applies shall arise immediately upon such contribution to the Trust.

5. The Trustees may without liability assume that no prior gifts to any holder of a withdrawal power under this Article were made by a donor or a donor’s spouse other than contributions to the trust, unless the Trustees shall have actual notice to the contrary.

§ 677 Income for benefit of grantor.

(a) General rule. The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be-

(1) distributed to the grantor or the grantor's spouse;

(2) held or accumulated for future distribution to the grantor or the grantor's spouse; or

(3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse (except policies of insurance irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the occurrence of the event unless the power is relinquished.

(b) Obligations of support.

Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse) whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661(a) and shall be taxed to the grantor under section 662.

Treasury Regulations:

§ 1.677(a)-1. Income for benefit of grantor; general rule.

(a)(1) *Scope.* Section 677 deals with the treatment of the grantor of a trust as the owner of a portion of the trust because he has retained an interest in the income from that portion. For convenience, "grantor" and "spouse" are generally referred to in the masculine and feminine genders, respectively, but if the grantor is a woman the reference to "grantor" is to her and the reference to "spouse" is to her husband. Section 677 also deals with the treatment of the grantor of a trust as the owner of a portion of the trust because the income from property transferred in trust after October 9, 1969, or may be, distributed to his spouse or applied to the payment of premiums on policies of insurance on the life of his spouse. However, section 677 does not apply when the income of a trust is taxable to a grantor's spouse under section 71 (relating to alimony and separate maintenance payments) or section 682 (relating to income of an estate or trust in case of divorce, etc.). See section 671-1(b).

(2) *Cross references.* See section 671 and §§1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit when a person is treated as the owner of all or a portion of a trust.

(b) Income for benefit of grantor or his spouse; general rule.

(1) *Property transferred in trust prior to October 10, 1969.* With respect to property transferred in trust prior to October 10, 1969, the grantor is treated, under section 677, in any taxable year as the owner (whether or not he is treated as an owner under section 674) of a portion of a trust of which the income for the taxable year or for a period not within the exception described in paragraph (e) of this section is, or in the discretion of the grantor or a nonadverse party, or both (without the approval or consent of any adverse party) may be:

(i) Distributed to the grantor;

- (ii) Held or accumulated for future distribution to the grantor; or
- (iii) Applied to the payment or premiums on policies of insurance on the life of the grantor, except policies of insurance irrevocably payable for a charitable purpose specified in section 170(c).

(2) *Property transferred in trust after October 9, 1969.* With respect to property transferred in trust after October 9, 1969, the grantor is treated, under section 677, in any taxable year as the owner (whether or not he is treated as an owner under section 674) of a portion of a trust of which the income for the taxable year or for a period not within the exception described in paragraph (e) of this section is, or in the discretion of the grantor, or his spouse, or a nonadverse party, or any combination thereof (without the approval or consent of any adverse party other than the grantor's spouse) may be:

- (i) Distributed to the grantor or the grantor's spouse;
- (ii) Held or accumulated for future distribution to the grantor or the grantor's spouse; or
- (iii) Applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, except policies of insurance irrevocably payable for a charitable purpose specified in section 170(c).

With respect to the treatment of a grantor as the owner of a portion of a trust solely because its income is, or may be, distributed or held or accumulated for future distributions to a beneficiary who is his spouse or applied to the payment of premiums for insurance on the spouse's life, section 677(a) applies to the income of a trust solely during the period of the marriage of the grantor to a beneficiary. In the case of divorce or separation, see sections 71 and 682 and the regulations thereunder.

(c) *Constructive distribution; cessation of interest.* Under section 677 the grantor is treated as the owner of a portion of a trust if he has retained any interest which might, without the approval or consent of an adverse party, enable him to have the income from that portion, distributed to him at some time, either actually or constructively (subject to the exception described in paragraph (e) of this section). In the case of a transfer in trust after October 9, 1969, the grantor is also treated as the owner of a portion of a trust if he has granted or retained any interest which might, without the approval or consent of an adverse party (other than the grantor's spouse), enable his spouse to have the income from the portion at some time, whether or not within the grantor's lifetime, distributed to the spouse either actually or constructively. See paragraph (b)(2) of this section for additional rules relating to the income of a trust prior to the grantor's marriage to a beneficiary. Constructive distribution to the grantor or to his spouse includes payment on behalf of the grantor or his spouse to another in obedience to his or her direction and payment of premiums upon policies of insurance on the grantor's, or his spouse's, life (other than policies of insurance irrevocably payable for charitable purposes specified in section 170(c)). If the grantor (in the case of property transferred prior to Oct. 10, 1969) or the grantor and his spouse (in the case of property transferred after Oct. 9, 1969) are divested permanently and completely of every interest described in this paragraph, the grantor is not treated as an owner under section 677 after that divesting. The word "interest" as used in this paragraph does not include the possibility that the grantor or his spouse might receive back from a beneficiary an interest in a trust by inheritance. Further, with respect to transfers in trust prior to October 10, 1969, the word "interest" does not include the possibility that the grantor might receive back from a beneficiary an interest in a trust as a surviving spouse under a statutory right of election or a similar right.

(d) *Discharge of legal obligation of grantor or his spouse.* Under section 677 a grantor is, in general, treated as owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor (or his spouse in the case of property transferred in trust by the grantor after October 9, 1969). However, see §1.677(b)-1 for special rules for trusts whose income may not be applied for the discharge of any legal obligation of the grantor or the grantor's spouse other than the

support or maintenance of a beneficiary (other than the grantor's spouse) whom the grantor is legally obligated to support. See §301.7701-4(e) of this chapter for rules on the classification of and application of section 677 to an environmental remediation trust.

(e) Exception for certain discretionary rights affecting income. The last sentence of section 677(a) provides that a grantor shall not be treated as the owner when a discretionary right can only affect the beneficial enjoyment of the income of a trust received after a period of time during which a grantor would not be treated as an owner under section 673 if the power were a reversionary interest. See §§1.673(a)-1 and 1.673(b)-1. For example, if the ordinary income of a trust is payable to B for 10 years and then in the grantor's discretion income or corpus may be paid to B or to the grantor (or his spouse in the case of property transferred in trust by the grantor after October 9, 1969), the grantor is not treated as an owner with respect to ordinary income under section 677 during the first 10 years. He will be treated as an owner under section 677 after the expiration of the 10-year period unless the power is relinquished. If the beginning of the period during which the grantor may substitute beneficiaries is postponed, the rules set forth in §1.673(d)-1 are applicable in determining whether the grantor should be treated as an owner during the period following the postponement.

(f) Accumulation of income. If income is accumulated in any taxable year for future distribution to the grantor (or his spouse in the case of property transferred in trust by the grantor after Oct. 9, 1969), section 677(a)(2) treats the grantor as an owner for that taxable year. The exception set forth in the last sentence of section 677(a) does not apply merely because the grantor (or his spouse in the case of property transferred in trust by the grantor after Oct. 9, 1969) must await the expiration of a period of time before he or she can receive or exercise discretion over previously accumulated income of the trust, even though the period is such that the grantor would not be treated as an owner under section 673 if a reversionary interest were involved. Thus, if income (including capital gains) of a trust is to be accumulated for 10 years and then will be, or at the discretion of the grantor, or his spouse in the case of property transferred in trust after October 9, 1969, or a nonadverse party, may be, distributed to the grantor (or his spouse in the case of property transferred in trust after Oct. 9, 1969), the grantor is treated as the owner of the trust from its inception. If income attributable to transfers after October 9, 1969 is accumulated in any taxable year during the grantor's lifetime for future distribution to his spouse, section 677(a)(2) treats the grantor as an owner for that taxable year even though his spouse may not receive or exercise discretion over such income prior to the grantor's death.

(g) Examples. The application of section 677(a) may be illustrated by the following examples:

Example (1). G creates an irrevocable trust which provides that the ordinary income is to be payable to him for life and that on his death the corpus shall be distributed to B, an unrelated person. Except for the right to receive income, G retains no right or power which would cause him to be treated as an owner under sections 671 through 677. Under the applicable local law capital gains must be applied to corpus. During the taxable year 1970 the trust has the following items of gross income and deductions:

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

Since G has a right to receive income he is treated as an owner of a portion of the trust under section 677. Accordingly, he should include the \$5,000 of dividends, \$200 income expense, and \$100 corpus expense in the computation of his taxable income for 1970. He should not include the \$1,000 capital gain since that is not attributable to the portion of the trust that he owns. See §1.671-3(b). The tax consequences of the capital gain are governed by the provisions of

subparts A, B, C, and D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Had the trust sustained a capital loss in any amount the loss would likewise not be included in the computation of G's taxable income, but would also be governed by the provisions of such subparts.

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

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

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

Therefore, he must include the capital gain in the computation of his taxable income. (Had the trust sustained a capital loss in any amount, G would likewise include that loss in the computation of his taxable income.) In addition, because of G's discretionary right (whether exercised or not) he is treated as the owner of a portion of the trust which will permit a distribution of income to him of \$5,000. Accordingly, G includes dividends of \$5,208.33 and income expenses of \$208.33 in computing his taxable income, determined in the following manner:

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

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

§ 1.677(b)-1. Trusts for support.

(a) Section 677(b) provides that a grantor is not treated as the owner of a trust merely because its income may in the discretion of any person other than the grantor (except when he is acting as trustee or cotrustee) be applied or distributed for the support or maintenance of a beneficiary

(other than the grantor's spouse in the case of income from property transferred in trust after October 9, 1969), such as the child of the grantor, whom the grantor or his spouse is legally obligated to support. If income of the current year of the trust is actually so applied or distributed the grantor may be treated as the owner of any portion of the trust under section 677 to that extent, even though it might have been applied or distributed for other purposes. In the case of property transferred to a trust before October 10, 1969, for the benefit of the grantor's spouse, the grantor may be treated as the owner to the extent income of the current year is actually applied for the support or maintenance of his spouse.

(b) If any amount applied or distributed for the support of a beneficiary including the grantor's spouse in the case of property transferred in trust before October 10, 1969, whom the grantor is legally obligated to support is paid out of corpus or out of other than income of the current year, the grantor is treated as a beneficiary of the trust, and the amount applied or distributed is considered to be an amount paid within the meaning of section 661(a)(2), taxable to the grantor under section 662. Thus, he is subject to the other relevant portions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Accordingly, the grantor may be taxed on an accumulation distribution or a capital gain distribution under subpart D (section 665 and following) of such part I. Those provisions, including the exceptions in section 665, are applied on the basis that the grantor is the beneficiary.

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

(d) The exception provided in section 677(b) relates solely to the satisfaction of the grantor's legal obligation to support or maintain a beneficiary. Consequently, the general rule of section 677(a) is applicable when in the discretion of the grantor or nonadverse parties income of a trust may be applied in discharge of a grantor's obligations other than his obligation of support or maintenance falling within section 677(b). Thus, if the grantor creates a trust the income of which may in the discretion of a nonadverse party be applied in the payment of the grantor's debts, such as the payment of his rent or other household expenses, he is treated as an owner of the trust regardless of whether the income is actually so applied.

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

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

§678 Person other than grantor treated as substantial owner.

(a) General rule. A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

(1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or

(2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

(b) Exception where grantor is taxable.

Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.

(c) Obligations of support.

Subsection (a) shall not apply to a power which enables such person, in the capacity of trustee or co-trustee, merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income of the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661(a) and shall be taxed to the holder of the power under section 662.

(d) Effect of renunciation or disclaimer.

Subsection (a) shall not apply with respect to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence.

(e) Cross reference.

For provision under which beneficiary of trust is treated as owner of the portion of the trust which consists of stock in an S corporation, see section 1361(d).

Treasury Regulations

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

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

(b) Section 678(a) treats a person as an owner of a trust if he has a power exercisable solely by himself to apply the income or corpus for the satisfaction of his legal obligations, other than an obligation to support a dependent (see §1.678(c)-1) subject to the limitation of section 678(b). Section 678 does not apply if the power is not exercisable solely by himself. However, see §1.662(a)-4 for principles applicable to income of a trust which, pursuant to the terms of the trust instrument, is used to satisfy the obligations of a person other than the grantor.

§1.678(b)-1. If grantor is treated as the owner.

Section 678(a) does not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is treated as the owner under sections 671 to 677, inclusive.

§1.678(c)-1. Trusts for support.

(a) Section 678(a) does not apply to a power which enables the holder, in the capacity of trustee or cotrustee, to apply the income of the trust to the support or maintenance of a person whom the holder is obligated to support, except to the extent the income is so applied. See paragraphs (a), (b), and (c) of §1.677(b)-1 for applicable principles where any amount is applied for the support or maintenance of a person whom the holder is obligated to support.

(b) The general rule in section 678(a) (and not the exception in section 678(c)) is applicable in any case in which the holder of a power exercisable solely by himself is able, in any capacity other than that of trustee or cotrustee, to apply the income in discharge of his obligation of support or maintenance.

(c) Section 678(c) is concerned with the taxability of income subject to a power described in section 678(a). It has no application to the taxability of income which is either required to be applied pursuant to the terms of the trust instrument or is applied pursuant to a power which is not described in section 678(a), the taxability of such income being governed by other provisions of the Code. See §1.662(a)-4.

§ 1.678(d)-1. Renunciation of power.

Section 678(a) does not apply to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence.