

market value at the time it was distributed, credited, or required to be distributed.

(3) The basis of the property in the hands of the beneficiary is its fair market value at the time it was paid, credited, or required to be distributed, to the extent such value is included in the gross income of the beneficiary. To the extent that the value of property distributed in kind is not included in the gross income of the beneficiary, its basis in the hands of the beneficiary is governed by the rules in sections 1014 and 1015 and the regulations thereunder. For this purpose, if the total value of cash and property distributed, credited, or required to be distributed in kind to a beneficiary in any taxable year exceeds the amount includible in his gross income for that year, the value of the property other than cash is normally considered as includible in his gross income only to the extent that the amount includible exceeds the cash paid, credited, or required to be distributed to the beneficiary in that year. Further, to the extent that the value of different items of property other than cash is includible in the gross income of a beneficiary in accordance with the preceding sentence, a pro rata portion of the total value of each item of property distributed, credited, or required to be distributed is normally considered as includible in the beneficiary's gross income.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7287, 38 FR 26912, Sept. 27, 1973]

§ 1.661(b)-1 Character of amounts distributed; in general.

In the absence of specific provisions in the governing instrument for the allocation of different classes of income, or unless local law requires such an allocation, the amount deductible for distributions to beneficiaries under section 661(a) is treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income. For example, if a trust has distributable net income of \$20,000, consisting of \$10,000 each of taxable interest and royalties and distributes \$10,000 to beneficiary A, the deduc-

tion of \$10,000 allowable under section 661(a) is deemed to consist of \$5,000 each of taxable interest and royalties, unless the trust instrument specifically provides for the distribution or accumulation of different classes of income or unless local law requires such an allocation. See also § 1.661(c)-1.

§ 1.661(b)-2 Character of amounts distributed when charitable contributions are made.

In the application of the rule stated in § 1.661(b)-1, the items of deduction which enter into the computation of distributable net income are allocated among the items of income which enter into the computation of distributable net income in accordance with the rules set forth in § 1.652(b)-3, except that, in the absence of specific provisions in the governing instrument, or unless local law requires a different apportionment, amounts paid, permanently set aside, or to be used for the charitable, etc., purposes specified in section 642(c) are first ratably apportioned among each class of items of income entering into the computation of the distributable net income of the estate or trust, in accordance with the rules set out in paragraph (b) of § 1.643(a)-5.

§ 1.661(c)-1 Limitation on deduction.

An estate or trust is not allowed a deduction under section 661(a) for any amount which is treated under section 661(b) as consisting of any item of distributable net income which is not included in the gross income of the estate or trust. For example, if in 1962, a trust, which reports on the calendar year basis, has distributable net income of \$20,000, which is deemed to consist of \$10,000 of dividends and \$10,000 of tax-exempt interest, and distributes \$10,000 to beneficiary A, the deduction allowable under section 661(a) (computed without regard to section 661(c)) would amount to \$10,000 consisting of \$5,000 of dividends and \$5,000 of tax-exempt interest. The deduction actually allowable under section 661(a) as limited by section 661(c) is \$4,975, since no deduction is allowable for the \$5,000 of tax-exempt interest and the \$25 deemed distributed out of the \$50 of dividends excluded under

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section 116, items of distributable net income which are not included in the gross income of the estate or trust.

[T.D. 6777, 29 FR 17809, Dec. 16, 1964]

§ 1.661(c)-2 Illustration of the provisions of section 661.

The provisions of section 661 may be illustrated by the following example:

Example. (a) Under the terms of a trust, which reports on the calendar year basis, \$10,000 a year is required to be paid out of income to a designated charity. The balance of the income may, in the trustee's discretion, be accumulated or distributed to beneficiary A. Expenses are allocable against income and the trust instrument requires a reserve for depreciation. During the taxable year 1955 the trustee contributes \$10,000 to charity and in his discretion distributes \$15,000 of income to A. The trust has the following items of income and expense for the taxable year 1955:

Partially tax-exempt interest.....	10,000
Fully tax-exempt interest.....	10,000
Rents.....	20,000
Rental expenses.....	2,000
Depreciation of rental property.....	3,000
Trustee's commissions.....	5,000

(b) The income of the trust for fiduciary accounting purposes is \$40,000, computed as follows:

Dividends.....	\$10,000
Partially tax-exempt interest.....	10,000
Fully tax-exempt interest.....	10,000
Rents.....	20,000
Total.....	50,000
Less:	
Rental expenses.....	\$2,000
Depreciation.....	3,000
Trustee's commissions.....	5,000
	10,000

Income as computed under section 643(b)..... 40,000

(c) The distributable net income of the trust as computed under section 643(a) is \$30,000, determined as follows:

Rents.....		\$20,000
Dividends.....		10,000
Partially tax-exempt interest.....		10,000
Fully tax-exempt interest.....	\$10,000	
Less:		
Expenses allocable thereto (10,000/50,000×\$5,000).....	\$1,000	
Charitable contributions allocable thereto (10,000/50,000×\$10,000).....	2,000	
	3,000	
		7,000
Total.....		47,000
Deductions:		
Rental expenses.....	2,000	
Depreciation of rental property.....	3,000	
Trustee's commissions (\$5,000 less \$1,000 allocated to tax-exempt interest).....	4,000	
Charitable contributions (\$10,000 less \$2,000 allocated to tax-exempt interest) ..	8,000	
	17,000	
Distributable net income (section 643(a)).....		30,000

(d) The character of the amounts distributed under section 661(a), determined in accordance with the rules prescribed in §§ 1.661(b)-1 and 1.661(b)-2 is shown by the following table (for the purpose of this alloca-

tion, it is assumed that the trustee elected to allocate the trustee's commissions to rental income except for the amount required to be allocated to tax-exempt interest):

	Rental income	Taxable dividends	Excluded dividends	Partially tax-exempt interest	Tax-exempt interest	Total
Trust income	\$20,000	\$9,950	\$50	\$10,000	\$10,000	\$50,000
Less:						
Charitable contributions	4,000	2,000	.....	2,000	2,000	10,000
Rental expenses	2,000	.....	.....	.....	.....	2,000
Depreciation	3,000	.....	.....	.....	.....	3,000