specified for the elections, the following transactions are deemed to occur under this paragraph (g) as a result of the elections, with each successive transaction occurring on the same day immediately after the preceding transaction S1 is treated as liquidating into Parent, then S2 is treated as liquidating into Parent, and finally S3 is treated as liquidating into Parent.

(4) *Effective date.* Except as otherwise provided in paragraph (g)(2)(ii) of this section, this paragraph (g) applies to elections that are filed on or after November 29, 1999. Taxpayers may apply this paragraph (g) retroactively to elections filed before November 29, 1999 if all taxpayers affected by the deemed transactions file consistently with this paragraph (g).

(h) *Effective date*—(1) *In general.* Except as otherwise provided in this section, the rules of this section are applicable as of January 1, 1997.

(2) *Prior treatment of existing entities.* In the case of a business entity that is not described in § 301.7701–2(b) (1), (3), (4), (5), (6), or (7), and that was in existence prior to January 1, 1997, the entity's claimed classification(s) will be respected for all peri0ods prior to January 1, 1997, if—

(i) The entity had a reasonable basis (within the meaning of section 6662) for its claimed classification;

(ii) The entity and all members of the entity recognized the federal tax consequences of any change in the entity's classification within the sixty months prior to January 1, 1997; and

(iii) Neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination (in which case the entity's classification will be determined in the examination).

[T.D. 8697, 61 FR 66590, Dec. 18, 1996; 62 FR 11769, Mar. 13, 1997, as amended by T.D. 8767, 63 FR 14619, Mar. 26, 1998; T.D. 8827, 64 FR 37678, July 13, 1999; 64 FR 58782, Nov. 1, 1999; T.D. 8844, 64 FR 66583, Nov. 29, 1999; T.D. 8970, 66 FR 64912, Dec. 17, 2001; T.D. 9093, 68 FR 60298, Oct. 22, 2003; T.D. 9100, 68 FR 70709, Dec. 19, 2003]

§ 301.7701–3T Classification of certain business entities (temporary).

(a) through (c)(1)(i) [Reserved]. For further guidance, *see* § 301.7701–3(a) through (c)(1)(i).

(ii) *Further notification of elections.* An eligible entity required to file a federal tax or information return for the taxable year for which an election is made under § 301.7701–3(c)(1)(i) must attach a copy of its Form 8832 to its federal tax or information return for that year. If the entity is not required to file a return for that year, a copy of its Form 8832 (''Entity Classification Election'') must be attached to the federal income tax or information return of any direct or indirect owner of the entity for the taxable year of the owner that includes the date on which the election was effective. An indirect owner of the entity does not have to attach a copy of the Form 8832 to its return if an entity in which it has an interest is already filing a copy of the Form 8832 with its return. If an entity, or one of its direct or indirect owners, fails to attach a copy of a Form 8832 to its return as directed in this section, an otherwise valid election under § 301.7701–3(c)(1)(i) will not be invalidated, but the non-filing party may be subject to penalties, including any applicable penalties if the federal tax or information returns are inconsistent with the entity's election under § 301.7701–3(c)(1)(i). In the case of returns for taxable years beginning after December 31, 2002, the copy of Form 8832 attached to a return pursuant to this paragraph (c)(1)(ii) is not required to be a signed copy.

(c)(1)(iii) through (h) [Reserved]. For further guidance, *see* § 301.7701–3(c)(1)(iii) through (h).

[T.D. 9100, 68 FR 70709, Dec. 19, 2003]

§ 301.7701–4 Trusts.

(a) *Ordinary trusts.* In general, the term ''trust'' as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a

trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

(b) *Business trusts.* There are other arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Internal Revenue Code because they are not simply arrangements to protect or conserve the property for the beneficiaries. These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code. However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or partnership. The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if the organization is more properly classified as a business entity under § 301.7701–2.

(c) *Certain investment trusts*—(1) An ''investment'' trust will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. *See Commissioner v. North American Bond Trust,* 122 F. 2d 545 (2d Cir. 1941), *cert. denied,* 314 U.S. 701 (1942). An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets of the trust, will be classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders. An investment trust with multiple classes of ownership interests ordinarily will be classified as a business entity under § 301.7701–2; however, an investment trust with multiple classes of ownership interests, in which there is no power under the trust agreement to vary the investment of the certificate holders, will be classified as a trust if the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose.

(2) The provisions of paragraph (c)(1) of this section may be illustated by the following examples:

Example 1. A corporation purchases a portfolio of residential mortgages and transfers the mortgages to a bank under a trust agreement. At the same time, the bank as trustee delivers to the corporation certificates evidencing rights to payments from the pooled mortgages; the corporation sells the certificates to the public. The trustee holds legal title to the mortgages in the pool for the benefit of the certificate holders but has no power to reinvest proceeds attributable to the mortgages in the pool or to vary investments in the pool in any other manner. There are two classes of certificates. Holders of class A certificates are entitled to all payments of mortgage principal, both scheduled and prepaid, until their certificates are retired; holders of class B certificates receive payments of principal only after all class A certificates have been retired. The different rights of the class A and class B certificates serve to shift to the holders of the class A certificates, in addition to the earlier scheduled payments of principal, the risk that mortgages in the pool will be prepaid so that the holders of the class B certificates will have ''call protection'' (freedom from premature termination of their interests on account of prepayments). The trust thus serves to create investment interests with respect to the mortgages held by the trust that differ significantly from direct investment in the mortgages. As a consequence, the existence of multiple classes of trust ownership is not incidental to any purpose of the trust to

facilitate direct investment, and, accordingly, the trust is classified as a business entity under § 301.7701–2.

Example 2. Corporation M is the originator of a portfolio of residential mortgages and transfers the mortgages to a bank under a trust agreement. At the same time, the bank as trustee delivers to M certificates evidencing rights to payments from the pooled mortgages. The trustee holds legal title to the mortgages in the pool for the benefit of the certificate holders, but has no power to reinvest proceeds attributable to the mortgages in the pool or to vary investments in the pool in any other manner. There are two classes of certificates. Holders of class C certificates are entitled to receive 90 percent of the payments of principal and interest on the mortgages; class D certificate holders are entitled to receive the other ten percent. The two classes of certificates are identical except that, in the event of a default on the underlying mortgages, the payment rights of class D certificate holders are subordinated to the rights of class C certificate holders. M sells the class C certificates to investors and retains the class D certificates. The trust has multiple classes of ownership interests, given the greater security provided to holders of class C certificates. The interests of certificate holders, however, are substantially equivalent to undivided interests in the pool of mortgages, coupled with a limited recourse guarantee running from M to the holders of class C certificates. In such circumstances, the existence of multiple classes of ownership interests is incidental to the trust's purpose of facilitating direct investment in the assets of the trust. Accordingly, the trust is classified as a trust.

Example 3. A promoter forms a trust in which shareholders of a publicly traded corporation can deposit their stock. For each share of stock deposited with the trust, the participant receives two certificates that are initially attached, but may be separated and traded independently of each other. One certificate represents the right to dividends and the value of the underlying stock up to a specified amount; the other certificate represents the right to appreciation in the stock's value above the specified amount. The separate certificates represent two different classes of ownership interest in the trust, which effectively separate dividend rights on the stock held by the trust from a portion of the right to appreciation in the value of such stock. The multiple classes of ownership interests are designed to permit investors, by transferring one of the certificates and retaining the other, to fulfill their varying investment objectives of seeking primarily either dividend income or capital appreciation from the stock held by the trust. Given that the trust serves to create investment interests with respect to the stock held by the trust that differ significantly from direct investment in such stock, the trust is not formed to facilitate direct investment in the assets of the trust. Accordingly, the trust is classified as a business entity under § 301.7701–2.

Example 4. Corporation N purchases a portfolio of bonds and transfers the bonds to a bank under a trust agreement. At the same time, the trustee delivers to N certificates evidencing interests in the bonds. These certificates are sold to public investors. Each certificate represents the right to receive a particular payment with respect to a specific bond. Under section 1286, stripped coupons and stripped bonds are treated as separate bonds for federal income tax purposes. Although the interest of each certificate holder is different from that of each other certificate holder, and the trust thus has multiple classes of ownership, the multiple classes simply provide each certificate holder with a direct interest in what is treated under section 1286 as a separate bond. Given the similarity of the interests acquired by the certificate holders to the interests that could be acquired by direct investment, the multiple classes of trust interests merely facilitate direct investment in the assets held by the trust. Accordingly, the trust is classified as a trust.

(d) *Liquidating trusts.* Certain organizations which are commonly known as liquidating trusts are treated as trusts for purposes of the Internal Revenue Code. An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose. A liquidating trust is treated as a trust for purposes of the Internal Revenue Code because it is formed with the objective of liquidating particular assets and not as an organization having as its purpose the carrying on of a profit-making business which normally would be conducted through business organizations classified as corporations or partnerships. However, if the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust. Bondholders' protective committees, voting trusts, and other agencies formed to protect the

interests of security holders during insolvency, bankruptcy, or corporate reorganization proceedings are analogous to liquidating trusts but if subsequently utilized to further the control or profitable operation of a going business on a permanent continuing basis, they will lose their classification as trusts for purposes of the Internal Revenue Code.

(e) *Environmental remediation trusts.* (1) An environmental remediation trust is considered a trust for purposes of the Internal Revenue Code. For purposes of this paragraph (e), an organization is an environmental remediation trust if the organization is organized under state law as a trust; the primary purpose of the trust is collecting and disbursing amounts for environmental remediation of an existing waste site to resolve, satisfy, mitigate, address, or prevent the liability or potential liability of persons imposed by federal, state, or local environmental laws; all contributors to the trust have (at the time of contribution and thereafter) actual or potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for environmental remediation of the waste site; and the trust is not a qualified settlement fund within the meaning of § 1.468B–1(a) of this chapter. An environmental remediation trust is classified as a trust because its primary purpose is environmental remediation of an existing waste site and not the carrying on of a profit-making business that normally would be conducted through business organizations classified as corporations or partnerships. However, if the remedial purpose is altered or becomes so obscured by business or investment activities that the declared remedial purpose is no longer controlling, the organization will no longer be classified as a trust. For purposes of this paragraph (e), environmental remediation includes the costs of assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, and collecting amounts from persons liable or potentially liable for the costs of these activities. For purposes of this paragraph (e), persons have potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for remediation of the existing waste site if there is authority under a federal, state, or local law that requires or could reasonably be expected to require such persons to satisfy all or a portion of the costs of the environmental remediation.

(2) Each contributor (grantor) to the trust is treated as the owner of the portion of the trust contributed by that grantor under rules provided in section 677 and § 1.677(a)–1(d) of this chapter. Section 677 and § 1.677(a)–1(d) of this chapter provide rules regarding the treatment of a grantor as the owner of a portion of a trust applied in discharge of the grantor's legal obligation. Items of income, deduction, and credit attributable to an environmental remediation trust are not reported by the trust on Form 1041, but are shown on a separate statement to be attached to that form. See § 1.671–4(a) of this chapter. The trustee must also furnish to each grantor a statement that shows all items of income, deduction, and credit of the trust for the grantor's taxable year attributable to the portion of the trust treated as owned by the grantor. The statement must provide the grantor with the information necessary to take the items into account in computing the grantor's taxable income, including information necessary to determine the federal tax treatment of the items (for example, whether an item is a deductible expense under section 162(a) or a capital expenditure under section 263(a)) and how the item should be taken into account under the economic performance rules of section 461(h) and the regulations thereunder. See § 1.461–4 of this chapter for rules relating to economic performance.

(3) All amounts contributed to an environmental remediation trust by a grantor (cash-out grantor) who, pursuant to an agreement with the other grantors, contributes a fixed amount to the trust and is relieved by the other grantors of any further obligation to make contributions to the trust, but remains liable or potentially liable under the applicable environmental

laws, will be considered amounts contributed for remediation. An environmental remediation trust agreement may direct the trustee to expend amounts contributed by a cash-out grantor (and the earnings thereon) before expending amounts contributed by other grantors (and the earnings thereon). A cash-out grantor will cease to be treated as an owner of a portion of the trust when the grantor's portion is fully expended by the trust.

(4) The provisions of this paragraph (e) may be illustrated by the following example:

Example. (a) *X*, *Y*, and *Z* are calendar year corporations that are liable for the remediation of an existing waste site under applicable federal environmental laws. On June 1, 1996, pursuant to an agreement with the governing federal agency, *X*, *Y*, and *Z* create an environmental remediation trust within the meaning of paragraph (e)(1) of this section to collect funds contributed to the trust by *X*, *Y*, and *Z* and to carry out the remediation of the waste site to the satisfaction of the federal agency. *X*, *Y*, and *Z* are jointly and severally liable under the federal environmental laws for the remediation of the waste site, and the federal agency will not release *X*, *Y*, or *Z* from liability until the waste site is remediated to the satisfaction of the agency.

(b) The estimated cost of the remediation is $20,000,000. *X*, *Y*, and *Z* agree that, if *Z* contributes $1,000,000 to the trust, *Z* will not be required to make any additional contributions to the trust, and *X* and *Y* will complete the remediation of the waste site and make additional contributions if necessary.

(c) On June 1, 1996, *X*, *Y*, and *Z* each contribute $1,000,000 to the trust. The trust agreement directs the trustee to spend *Z*'s contributions to the trust and the income allocable to *Z*'s portion before spending *X*'s and *Y*'s portions. On November 30, 1996, the trustee disburses $2,000,000 for remediation work performed from June 1, 1996, through September 30, 1996. For the six-month period ending November 30, 1996, the interest earned on the funds in the trust was $75,000, which is allocated in equal shares of $25,000 to *X*'s, *Y*'s, and *Z*'s portions of the trust.

(d) *Z* made no further contributions to the trust. Pursuant to the trust agreement, the trustee expended *Z*'s portion of the trust before expending *X*'s and *Y*'s portion. Therefore, *Z*'s share of the remediation disbursement made in 1996 is $1,025,000 ($1,000,000 contribution by *Z* plus $25,000 of interest allocated to *Z*'s portion of the trust). *Z* takes the $1,025,000 disbursement into account under the appropriate federal tax accounting rules. In addition, *X*'s share of the remediation disbursement made in 1996 is $487,500, and *Y*'s share of the remediation disbursement made in 1996 is $487,500. *X* and *Y* take their respective shares of the disbursement into account under the appropriate federal tax accounting rules.

(e) The trustee made no further remediation disbursements in 1996, and *X* and *Y* made no further contributions in 1996. From December 1, 1996, to December 31, 1996, the interest earned on the funds remaining in the trust was $5,000, which is allocated $2,500 to *X*'s portion and $2,500 to *Y*'s portion. Accordingly, for 1996, *X* and *Y* each had interest income of $27,500 from the trust and *Z* had interest income of $25,000 from the trust.

(5) This paragraph (e) is applicable to trusts meeting the requirements of paragraph (e)(1) of this section that are formed on or after May 1, 1996. This paragraph (e) may be relied on by trusts formed before May 1, 1996, if the trust has at all times met all requirements of this paragraph (e) and the grantors have reported items of ,income and deduction consistent with this paragraph (e) on original or amended returns. For trusts formed before May 1, 1996, that are not described in the preceding sentence, the Commissioner may permit by letter ruling, in appropriate circumstances, this paragraph (e) to be applied subject to appropriate terms and conditions.

(f) *Effective date.* The rules of this section generally apply to taxable years beginning after December 31, 1960. Paragraph (e)(5) of this section contains rules of applicability for paragraph (e) of this section. In addition, the last sentences of paragraphs (b), (c)(1), and (c)(2) *Example 1* and *Example 3* of this section are effective as of January 1, 1997.

[32 FR 15241, Nov. 3, 1967, as amended by T.D. 8080, 51 FR 9952, Mar. 24, 1986; T.D. 8668, 61 FR 19191, May 1, 1996; T.D. 8697, 61 FR 66592, Dec. 18, 1996]

§ 301.7701–5 Domestic, foreign, resident, and nonresident persons.

A domestic corporation is one organized or created in the United States, including only the States (and during the periods when not States, the Territories of Alaska and Hawaii), and the District of Columbia, or under the law of the United States or of any State or Territory. A foreign corporation is one which is not domestic. A domestic corporation is a resident corporation even