

Notice of Proposed Rulemaking and Notice of Public Hearing

Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates

REG-108522-00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 684 of the Internal Revenue Code relating to recognition of gain on certain transfers to certain foreign trusts and estates. The proposed regulations affect United States persons who transfer property to foreign trusts and estates. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by November 6, 2000. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for November 8, 2000, must be submitted by October 18, 2000.

ADDRESSES: Send submissions to: CC:MSP:RU (REG-108522-00), room 5226, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:MSP:RU (REG-108522-00), 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.gov/tax_regs/regslst.html. The public hearing will be held in Room 3313, Internal Revenue Building, 1111 Constitution Ave., NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Karen A. Rennie Quarrie at (202) 622-3880; concerning the submissions and hearing, Sonya M. Cruse at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 684 of the Internal Revenue Code (Code) was added by Section 1131(b) of the Taxpayer Relief Act of 1997 (the Act), Public Law 105-34 (111 Stat. 788) (August 5, 1997). The addition affects the transfer of property by United States persons to certain foreign trusts and foreign estates.

1. *Prior Law*

Prior to the enactment of section 684, section 1491, with certain exceptions, imposed a 35-percent excise tax on transfers of property by a United States person to a foreign trust or estate. Section 1491 applied to all transfers of appreciated property whether or not at fair market value and whether or not the transfer was made with donative intent. The excise tax was intended to curtail transfers of appreciated property to foreign trusts, because a foreign trust could dispose of the property and invest the proceeds of the sale outside the United States without incurring any U.S. tax. If the excise tax applied, the foreign trust could not increase the basis of the property contributed to the trust. Under section 1492(3), the U.S. transferor could make an election under section 1057 to treat a transfer of appreciated property to a foreign trust as a sale or exchange of such property and pay an income tax instead of an excise tax on the gain.

2. *Overview of Changes*

Section 1131 of the Act repealed sections 1491 through 1494 and section 1057 of the Code and enacted section 684. In so doing, Congress eliminated the excise tax on transfers of appreciated property to foreign trusts and foreign estates in favor of an income tax on transfers of appreciated property to foreign trusts and foreign estates. Unlike previous law, however, Congress provided explicit regulatory authority to make exceptions to the mandatory tax on such transfers. These regulations explain the application of section 684 and provide certain exceptions from its application.

Pursuant to section 684(a) of the Code, any transfer of property by a U.S. person

to a foreign trust or estate is treated as a taxable disposition of the property, except to the extent provided in regulations. Such a transfer is treated as a sale or exchange of the property for its fair market value. The U.S. transferor must immediately recognize gain equal to the excess of the property's fair market value over its adjusted basis in the hands of the U.S. transferor.

Pursuant to section 684(b), a U.S. person will not be required to recognize gain on the transfer of property to a foreign trust if the U.S. transferor (or other person) is considered to be the owner of the trust under section 671.

Pursuant to section 684(c), if a domestic trust becomes a foreign trust, all trust assets are considered to be transferred to a foreign trust. Thus, appreciated property owned by the trust will be deemed sold on the date that the trust status changes from domestic to foreign, and gain must be recognized on that date.

Explanation of Provisions

§1.684-1 Recognition of gain on transfers to certain foreign trusts and estates

Subject to certain exceptions discussed below, the proposed regulations provide a general rule of immediate recognition of gain when a U.S. person transfers appreciated property to a foreign trust or estate. This immediate gain recognition applies even if the U.S. transferor might otherwise have been eligible to defer gain recognition under another provision of the Code. Losses are not permitted to be recognized under the provision. Moreover, if multiple assets are transferred, the U.S. transferor may not offset losses in some property against gains in other property under the provision.

A U.S. person who transfers property to a foreign trust must comply with the reporting requirements set forth in section 6048 of the Code. See Notice 97-34 (1997-1 C.B. 422), which provides guidance regarding the foreign trust reporting requirements under section 6048.

§1.684-2 Transfers

The proposed regulations define the term *transfer* broadly to mean any direct,

indirect or constructive transfer. The determination of whether an indirect or constructive transfer has occurred is made under the rules set forth in proposed regulation §1.679-3(c) and §1.679-3(d), respectively, published in REG-209038-89 on page 191.

The proposed regulations provide that, if a U.S. person is considered the owner of any portion of a trust, a transfer of property from that portion of the trust will be considered a transfer by the U.S. person that owns that portion of the trust. Thus, for example, a U.S. person cannot avoid the application of section 684 by first transferring property to a trust which he is treated as owning under the grantor trust rules, then having that trust transfer the property to a foreign trust that he is not treated as owning.

§1.684-3 Exceptions to the general rule of gain recognition

Under the proposed regulations, certain types of transfers are excepted from the general rule of gain recognition set forth in §1.684-1. A U.S. person who transfers property to a foreign trust will not be required to recognize gain on the transfer to the extent such trust is considered owned by any person. For example, if a U.S. person transfers property to a foreign trust that is treated as having a U.S. beneficiary under section 679 and the U.S. person is treated as the owner of the trust under that section, the general rule of gain recognition will not apply at that time. If, however, the trust subsequently ceases to be treated as owned by the U.S. person, §1.684-2(e) provides that the U.S. person will be treated as having transferred the assets of the trust to a foreign trust immediately before the U.S. person ceases to be considered the owner of the original trust. As a result, the U.S. person will be subject to the general rule of gain recognition at that time (unless another exception, such as the exception for certain transfers on death, applies).

A transfer by a U.S. person to a trust which has received a ruling or determination letter from the IRS recognizing the trust's exempt status under section 501(c)(3) will be exempt from the general rule of gain recognition if the trust's ruling or determination letter has been neither revoked nor modified.

The proposed regulations also provide an exception for transfers by a U.S. person to a foreign trust at death if the property transferred is included in the U.S. person's gross estate for U.S. estate tax purposes and the basis of the property in the hands of the foreign trust is determined under section 1014(a) of the Code. For example, if a U.S. person previously transferred property to a foreign trust and was treated as the owner of the trust under section 679, for purposes of section 684 the cessation of ownership status upon the U.S. person's death is treated as a deemed transfer to the foreign trust by the decedent immediately before her death. If the person retained sufficient powers over the trust to cause the trust property to be included in her gross estate for estate tax purposes and the basis of the property in the hands of the foreign trust is determined under section 1014(a) of the Code, the general rule of gain recognition does not apply. However, to the extent the trust property is not included in her estate and the foreign trust does not receive a step-up in basis in the property under section 1014(a), the exception does not apply.

The proposed regulations also provide an exception to the general rule of gain recognition under §1.684-1 if property is transferred for fair market value to an unrelated foreign trust. The determination of whether a foreign trust is a related foreign trust is made under the principles set forth in §1.679-1(c)(5). Thus, for example, if a U.S. person sells property for fair market value to an unrelated foreign trust, the general rule of section 684 will not apply. However, if the sale is to a related foreign trust, immediate gain recognition is required (unless another exception applies), even if another provision of the Code would permit deferral of recognition.

Finally, the proposed regulations provide that the general rule does not apply to a distribution to a trust with respect to an interest held by the trust in a non-trust entity (e.g., a corporation or partnership), or an interest in certain commercial trusts. For example, if a foreign trust owns stock of a U.S. corporation and the U.S. corporation makes a distribution to the trust that is properly characterized as a dividend with respect to the trust's stock ownership, section 684 does not apply.

§1.684-4 Outbound migration of domestic trust

The proposed regulations provide that if a U.S. person transfers property to a domestic trust and, for any reason, the domestic trust becomes a foreign trust, the domestic trust will be deemed to have transferred all of its assets to a foreign trust. The domestic trust must immediately recognize gain unless an exception in §1.684-3 applies at that time (e.g., the U.S. person is living at the time of the trust's change in status and is treated as the owner of the trust under section 679). The domestic trust must also fulfill the reporting requirements set forth in section 6048 of the Code and Notice 97-34.

The proposed regulations incorporate the relief for inadvertent migrations set forth in §301.7701-7(d)(2). For example, if a trust's status changes from domestic to foreign because of an inadvertent change in the trustee, the trust will avoid the application of the general gain recognition rule if, within 12 months, it makes necessary changes to the trustee in order to remain a domestic trust.

§1.684-5 Effective dates

This section of the proposed regulations provides effective dates with respect to §§1.684-1 through 1.684-4. The rules apply with respect to transfers of property to foreign trusts or foreign estates made after August 7, 2000. The primary reason for this effective date is to immediately address taxpayer concerns with respect to the provision of regulatory exceptions to the general rule of gain recognition under section 684(a). It should be noted, however, that the Internal Revenue Service is not restricted from applying general income tax principles to transactions prior to the effective dates of the proposed regulations to determine, for example, that a U.S. person has made a transfer to a foreign trust.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, regulatory assessment is not required. It has also 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 businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 8, 2000, 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 start of the hearing.

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 November 6, 2000, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 18, 2000.

A period of ten (10) minutes will be allocated to each person for making comments.

An agenda showing the scheduling to 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 Karen A. Rennie Quarrie of the Office of Associate Chief Counsel (International). 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 1 is 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 in part as follows:

Authority: 26 U.S.C. 7805 % % %

Section 1.684-1 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684-2 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684-3 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684-4 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684-5 also issued under 26 U.S.C. 643(a)(7) and 684(a). * * *

Par. 2. Sections 1.684-1, 1.684-2, 1.684-3, 1.684-4 and 1.684-5 are added under the undesignated centerheading "Miscellaneous" to read as follows:

§1.684-1 Recognition of gain on transfers to certain foreign trusts and estates.

(a) *Immediate recognition of gain*—(1) *In general.* Any U.S. person who transfers property to a foreign trust or foreign estate shall be required to recognize gain at the time of the transfer equal to the excess of the fair market value of the property transferred over the adjusted basis (for purposes of determining gain) of such property in the hands of the U.S. transferor unless an exception applies under the provisions of §1.684-3. The amount of gain recognized is determined on an asset-by-asset basis.

(2) *No recognition of loss.* Under this section a U.S. person may not recognize loss on the transfer of an asset to a foreign trust or foreign estate. A U.S. person may not offset gain realized on the transfer of an appreciated asset to a foreign trust or foreign estate by a loss realized on the transfer of a depreciated asset to the foreign trust or foreign estate.

(b) *Definitions.* The following definitions apply for purposes of this section:

(1) *U.S. person.* The term U.S. person means a United States person as defined in section 7701(a)(30), and includes a nonresident alien individual who elects under section 6013(g) to be treated as a resident of the United States.

(2) *U.S. transferor.* The term U.S. transferor means any U.S. person who makes a transfer (as defined in §1.684-2) of property to a foreign trust or foreign estate.

(3) *Foreign trust.* Section 7701(a)(31)(B) defines foreign trust.

(4) *Foreign estate.* Section 7701(a)(31)(A) defines foreign estate.

(c) *Reporting requirements.* A U.S. person who transfers property to a foreign trust or foreign estate must comply with the reporting requirements under section 6048.

(d) *Examples.* The following examples illustrate the rules of this section. In all examples, A is a U.S. person and FT is a foreign trust. The examples are as follows:

Example 1. Transfer to foreign trust. A transfers property that has a fair market value of 1000X to FT. A's adjusted basis in the property is 400X. FT has no U.S. beneficiary within the meaning of §1.679-2, and no person is treated as owning any portion of FT. Under paragraph (a)(1) of this section, A recognizes gain at the time of the transfer equal to 600X.

Example 2. Transfer of multiple properties. A transfers property Q, with a fair market value of 1000X, and property R, with a fair market value of 2000X, to FT. At the time of the transfer, A's adjusted basis in property Q is 700X, and A's adjusted basis in property R is 2200X. FT has no U.S. beneficiary within the meaning of §1.679-2, and no person is treated as owning any portion of FT. Under paragraph (a)(1) of this section, A recognizes the 300X of gain attributable to property Q. Under paragraph (a)(2) of this section, A does not recognize the 200X of loss attributable to property R, and may not offset that loss against the gain attributable to property Q.

Example 3. Transfer for less than fair market value. A transfers property that has a fair market value of 1000X to FT in exchange for 400X of cash. A's adjusted basis in the property is 200X. FT has no U.S. beneficiary within the meaning of §1.679-2, and no person is treated as owning any portion of FT. Under paragraph (a)(1) of this section, A recognizes gain at the time of the transfer equal to 800X.

Example 4. Exchange of property for private annuity. A transfers property that has a fair market value of 1000X to FT in exchange for FT's obligation to pay A 50X per year for the rest of A's life. The obligation has an issue price of 1000X. A's adjusted basis in the property is 100X. FT has no U.S. beneficiary within the meaning of §1.679-2, and no person is treated as owning any portion of FT. A is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though A might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code.

Example 5. Transfer of property to related foreign trust in exchange for qualified obligation. A transfers property that has a fair market value of 1000X to FT in exchange for FT's obligation to make payments to A during the next four years. FT

is related to A as defined in §1.679-1(c)(5). The obligation, which has an issue price of 1000X, is treated as a qualified obligation within the meaning of §1.679-4(d), and no person is treated as owning any portion of FT. A's adjusted basis in the property is 100X. A is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though A might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code. Section 1.684-3(d) provides rules relating to transfers for fair market value to unrelated foreign trusts.

§1.684-2 Transfers.

(a) *In general.* A transfer means a direct, indirect, or constructive transfer.

(b) *Indirect transfers—(1) In general.* Section 1.679-3(c) shall apply to determine if a transfer to a foreign trust or foreign estate, by any person, is treated as an indirect transfer by a U.S. person to the foreign trust or foreign estate.

(2) *Examples.* The following examples illustrate the rules of this paragraph (b). In all examples, A is a U.S. citizen, FT is a foreign trust, and I is A's uncle, who is a nonresident alien. The examples are as follows:

Example 1. Principal purpose of tax avoidance. A creates and funds FT for the benefit of A's cousin, who is a nonresident alien. FT has no U.S. beneficiary within the meaning of §1.679-2, and no person is treated as owning any portion of FT. In 2004, A decides to transfer additional property with a fair market value of 1000X and an adjusted basis of 600X to FT. Pursuant to a plan with a principal purpose of avoiding the application of section 684, A transfers the property to I. I subsequently transfers the property to FT. Under paragraph (b) of this section and §1.679-3(c), A is treated as having transferred the property to FT.

Example 2. U.S. person unable to demonstrate that intermediary acted independently. A creates and funds FT for the benefit of A's cousin, who is a nonresident alien. FT has no U.S. beneficiary within the meaning of §1.679-2, and no person is treated as owning any portion of FT. On July 1, 2004, A transfers property with a fair market value of 1000X and an adjusted basis of 300X to I, a foreign person. On January 1, 2007, at a time when the fair market value of the property is 1100X, I transfers the property to FT. A is unable to demonstrate to the satisfaction of the Commissioner, under §1.679-3(c)(2)(ii), that I acted independently of A in making the transfer to FT. Under this paragraph (b) and §1.679-3(c), A is treated as having transferred the property to FT. Under this paragraph (b) and §1.679-3(c)(3), I is treated as an agent of A, and the transfer is deemed to have been made on January 1, 2007. Under §1.684-1(a), A recognizes gain equal to 800X on that date.

(c) *Constructive transfers.* Section 1.679-3(d) shall apply to determine if a transfer to a foreign trust or foreign estate is treated as a constructive transfer by a

U.S. person to the foreign trust or foreign estate.

(d) *Transfers by certain trusts—(1) In general.* If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Examples.* The following examples illustrate the rules of this paragraph (d). In all examples, A is a U.S. person, DT is a domestic trust, and FT is a foreign trust. The examples are as follows:

Example 1. Transfer by a domestic trust. On January 1, 2001, A transfers property which has a fair market value of 1000X and an adjusted basis of 200X to DT. A retains the power to revoke DT. On January 1, 2003, DT transfers property which has a fair market value of 500X and an adjusted basis of 100X to FT. At the time of the transfer, FT has no U.S. beneficiary as defined in §1.679-2 and no person is treated as owning any portion of FT. A is treated as having transferred the property to FT and is required to recognize gain of 400X, under §1.684-1, at the time of the transfer by DT to FT.

Example 2. Transfer by a foreign trust. On January 1, 2001, A transfers property which has a fair market value of 1000X and an adjusted basis of 200X to FTI. At the time of the transfer, FTI has a U.S. beneficiary as defined in §1.679-2 and A is treated as the owner of FTI under section 679. On January 1, 2003, FTI transfers property which has a fair market value of 500X and an adjusted basis of 100X to FT2. At the time of the transfer, FT2 has no U.S. beneficiary as defined in §1.679-2 and no person is treated as owning any portion of FT2. A is treated as having transferred the property to FT2 and is required to recognize gain of 400X, under §1.684-1, at the time of the transfer by FTI to FT2.

(e) *Transfers when foreign trust no longer treated as owned by a U.S. person—(1) In general.* If any portion of a foreign trust is treated as owned by a U.S. person under subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, and such portion ceases to be treated as owned by that person under such subpart, the U.S. person shall be treated as having transferred, immediately before the trust is no longer treated as owned by that U.S. person, the assets of such portion to a foreign trust.

(2) *Examples.* The following examples illustrate the rules of this paragraph (e). In all examples, A is a U.S. citizen and FT is a foreign trust. The examples are as follows:

Example 1. Loss of U.S. beneficiary. (i) On January 1, 2001, A transfers property, which has a fair market value of 1000X and an adjusted basis of 400X, to FT. At the time of the transfer, FT has a U.S. beneficiary within the meaning of §1.679-2, and A is treated as owning FT under section 679.

Under §1.684-3(a), §1.684-1 does not cause A to recognize gain at the time of the transfer.

(ii) On July 1, 2003, FT ceases to have a U.S. beneficiary within the meaning of §1.679-2, and as of that date neither A nor any other person is treated as owning any portion of FT. On that date, the fair market value of the property is 1200X, and its adjusted basis equals 350X. Under paragraph (e)(1) of this section, A is treated as having transferred the property to FT on July 1, 2003, and must recognize 850X of gain at that time under §1.684-1.

Example 2. Death of grantor. (i) The initial facts are the same as in paragraph (i) of *Example 1*.

(ii) On July 1, 2003, A dies, and as of that date no other person is treated as the owner of FT. On that date, the fair market value of the property is 1200X, and its adjusted basis equals 350X. Under paragraph (e)(1) of this section, A is treated as having transferred the property to FT immediately before his death, and generally is required to recognize 850X of gain at that time under §1.684-1. However, an exception may apply under §1.684-3(c).

Example 3. Release of a power. (i) On January 1, 2001, A transfers property that has a fair market value of 500X and an adjusted basis of 200X to FT. At the time of the transfer, FT does not have a U.S. beneficiary within the meaning of §1.679-2. However, A retains the power to revoke the trust. A is treated as the owner of the trust under section 676 and, therefore, under §1.684-3(a), A is not required to recognize gain under §1.684-1 at the time of the transfer.

(ii) On January 1, 2007, A releases the power to revoke the trust and, as of that date, neither A nor any other person is treated as owning any portion of FT. On that date, the fair market value of the property is 900X, and its adjusted basis is 200X. Under paragraph (e)(1) of this section, A is treated as having transferred the property to FT on January 1, 2007, and must recognize 700X of gain at that time.

(f) *Transfers to entities owned by a foreign trust.* Section 1.679-3(f) provides rules that apply with respect to transfers of property by a U.S. person to an entity in which a foreign trust holds an ownership interest.

§1.684-3 Exceptions to general rule of gain recognition.

(a) *Transfers to grantor trusts.* The general rule of gain recognition under §1.684-1 shall not apply to any transfer of property by a U.S. person to a foreign trust to the extent that any person is treated as the owner of the trust under section 671. Section 1.684-2(e) provides rules regarding a subsequent change in the status of the trust.

(b) *Transfers to charitable trusts.* The general rule of gain recognition under §1.684-1 shall not apply to any transfer of property to a foreign trust that has received a ruling or determination letter, which has been neither revoked nor modified, from the Internal Revenue Service

recognizing the trust's exempt status under section 501(c)(3).

(c) *Certain transfers at death.* The general rule of gain recognition under §1.684-1 shall not apply to any transfer of property by reason of death of the U.S. transferor if such property is included in the gross estate of the U.S. transferor for Federal estate tax purposes and the basis of the property in the hands of the foreign trust is determined under section 1014(a).

(d) *Transfers for fair market value to unrelated trusts.* The general rule of gain recognition under §1.684-1 shall not apply to any transfer of property for fair market value to a foreign trust that is not a related foreign trust as defined in §1.679-1(c)(5). Section §1.671-2(e)(2)(ii) defines fair market value.

(e) *Certain distributions to trusts.* For purposes of this section, a transfer does not include a distribution to a trust with respect to an interest held by such trust in an entity other than a trust or 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.

(f) *Examples.* The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

Example 1. Transfer to owner trust. In 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *FT*. At the time of the transfer, *FT* has a U.S. beneficiary within the meaning of §1.679-2, and *A* is treated as owning *FT* under section 679. Under paragraph (a) of this section, §1.684-1 does not cause *A* to recognize gain at the time of the transfer. See §1.684-2(e) for rules that may require *A* to recognize gain if the trust is no longer owned by *A*.

Example 2. Property included in U.S. transferor's estate at death. (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retained the power to revoke *FT*, thus, the value of all property owned by *FT* at *A*'s death is includible in *A*'s gross estate for U.S. estate tax purposes. Pursuant to paragraph (c) of this section, *A* is not required to recognize gain under §1.684-1 to the extent the property is included in *A*'s gross estate and the basis of the property in the hands of the foreign trust is determined under section 1014(a).

Example 3. Property not included in U.S. transferor's estate at death. (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retained no power over *FT* and the value of the property transferred to *FT* is not required to be included in *A*'s gross estate. Under §1.684-2(e)(1), *A* is treated as having transferred the property to *FT* immediately before his death, and must recognize 1100X of gain at that time under §1.684-1.

Example 4. Transfer of property for fair market value to an unrelated foreign trust. *A* sells a house with a fair market value of 1000X to *FT* in exchange for a 30-year note issued by *FT*. *A* is not related to *FT* as defined in §1.679-1(c)(5). The note has an issue price of 1000X. *FT* is not treated as owned by any person. Pursuant to paragraph (d) of this section, *A* is not required to recognize gain under §1.684-1.

§1.684-4 Outbound migrations of domestic trusts.

(a) *In general.* If a U.S. person transfers property to a domestic trust, and such trust becomes a foreign trust, the trust shall be treated for purposes of this section as having transferred all of its assets to a foreign trust and the trust is required to recognize gain on the transfer under §1.684-1(a). The trust must also comply with the rules of section 6048.

(b) *Date of transfer.* The transfer described in this section shall be deemed to occur immediately before, but on the same date that, the trust meets the definition of a foreign trust set forth in section 7701(a)(31)(B).

(c) *Inadvertent migrations.* In the event of an inadvertent migration, as defined in §301.7701(d)(2) of this chapter, a trust may avoid the application of this section by complying with the procedures set forth in §301.7701-7(d)(2) of this chapter.

(d) *Examples.* The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen, *B* is a U.S. citizen, *C* is a nonresident alien, *T* is a trust. The examples are as follows:

Example 1. Migration of domestic trust with U.S. beneficiaries. *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust, for the benefit of *A*'s children who are also United States citizens. *B* is the trustee of *T*. On January 1, 2001, while *A* is still alive, *B* resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701-7(d) of this chapter, *T* becomes a foreign trust. *T* has U.S. beneficiaries within the meaning of §1.679-2 and *A* is, therefore, treated as owning *FT* under section 679. Pursuant to §1.684-3(a), neither *A* nor *T* is required to recognize gain at the time of the migration. Section 1.684-2(e) provides rules that may require *A* to recognize gain upon a subsequent change in the status of the trust.

Example 2. Migration of domestic trust with no U.S. beneficiaries. *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust for the benefit of *A*'s mother who is not a citizen or resident of the United States. *B* is the trustee of *T*. On January 1, 2001, while *A* is still alive, *B* resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701-7(d) of this chapter, *T* becomes a foreign trust, *FT*. *FT* has no U.S. beneficiaries within the meaning of §1.679-2 and no person is treated as owning any portion of *FT*. *T* is required to recognize gain of 600X on January 1, 2001. Paragraph (c) of this section provides rules with respect to an inadvertent migration of a domestic trust.

§1.684-5 Effective date.

(a) Sections 1.684-1 through 1.684-4 apply to transfers of property to foreign trusts and foreign estates after August 7, 2000.

David A. Mader,
Acting Deputy Commissioner
of Internal Revenue.

(Filed by the Office of the Federal Register on August 2, 2000, 1:04 p.m., and published in the issue of the Federal Register for August 7, 2000, 65 F.R. 48198)