Section 684.—Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates

26 CFR 1.684–1: Recognition of gain on transfers to certain foreign trusts and estates.

T.D. 8956

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 684 of the Internal Revenue Code relating to recog-

nition of gain on certain transfers to certain foreign trusts and estates. The regulations affect United States persons who transfer property to foreign trusts and estates.

DATES: *Effective Date*: These regulations are effective July 20, 2001.

Applicability Date: These regulations are applicable to transfers of property to foreign trusts and foreign estates after August 7, 2000.

FOR FURTHER INFORMATION CONTACT: Karen A. Rennie-Quarrie, (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations relating to the Income Tax Regulations (CFR part 1) under section 684 of the Internal Revenue Code (Code). On August 7, 2000, Treasury and the IRS published a notice of proposed rulemaking (REG–108522–00, 2000–34 I.R.B. 187) in the **Federal Register** (65 FR 48198) under section 684 of the Code relating to gain recognition on transfers of property by U.S. persons to foreign trusts and estates. Comments responding to the notice of proposed rulemaking were received and a public hearing was held on November 8, 2000. After consideration of all comments, the proposed regulations are adopted as final regulations as revised by this Treasury decision.

Explanation of Provisions

I. *Comments and Changes to §1.684–1: Recognition of Gain on Transfers to Certain Foreign Trusts and Estates*

Under the proposed regulations, a U.S. person who transfers property to a foreign trust or estate generally must recognize gain immediately even if deferral might otherwise be permitted under another provision of the Code.

One commenter questioned the authority for the conclusion in §1.684–1(d) *Example 4* that a U.S. person must recognize gain immediately upon the transfer of appreciated property to a foreign trust in exchange for a private annuity. The general rule in section 684(a) provides, in part, that the transfer to the foreign trust is treated as a sale or exchange for an amount equal to the fair market value of the property transferred and the transferor must recognize the gain in the property, except as provided in regulations. The language of section 684(a) does not provide for any deferral of this gain. Moreover, the legislative history of former section 1491 (the predecessor of section 684 regarding transfers of property by U.S. persons to foreign trusts) makes it clear that Congress did not look favorably upon deferral in the context of transfers to foreign trusts in exchange for private annuities: "The committee believes that any policy in favor of permitting deferral of tax in private annuity transactions should not apply to a private annuity transaction with a foreign trust." S. Rep. No. 94–938, at 217, n.5 (1976). Therefore, Treasury and the IRS do not believe it would be appropriate to adopt regulations that would permit deferral in such a case. The final regulations retain *Example 4* without modification.

II. *Comments and Changes to §1.684–2: Transfers*

The proposed regulations define the term *transfer* broadly to mean any direct, indirect, or constructive transfer. Section 1.684–2(e) of the proposed regulations provides that if any portion of a foreign trust is treated as owned by a U.S. person and such portion ceases to be treated as owned by such U.S. person, the U.S. person is treated as having transferred the assets of such portion to a foreign trust immediately before the trust is no longer treated as owned by the U.S. person. Section 1.684–2(e)(2) *Example 2* illustrates this rule in the case of the death of the grantor.

One commenter questioned the authority for the position that death is a transfer to which section 684 applies. Section 684(a) expressly applies to "*any* transfer of property by a United States person to a foreign estate or trust" (emphasis added). Section 679 also generally applies to transfers of property by U.S. persons to foreign trusts. In the case of section 679, however, section 679(a)(2)(A) specifically excepts transfers by reason of death from the application of the general rule of section 679. This exception implies that Congress believed that, unless otherwise excepted, a transfer by reason of death would be a transfer to which section 679 applied. Because Congress provided no exception in section 684 for transfers by reason of death, it follows that section 684 applies to such transfers. Additional support for this conclusion is found in the information reporting rules in section 6048(a)(3)(A)(ii), which provides that a "reportable event" includes "the transfer of any money or property (directly or indirectly) to a foreign trust by a United States person, *including a transfer by reason of death*" (emphasis added). Although section 684 generally applies to transfers by reason of death, §1.684–3(c) provides an exception to the general rule of gain recognition in the case of certain transfers at death.

One commenter requested guidance concerning a transfer of property by a domestic trust (that is not treated as owned by another person) to a foreign trust as a result of the testamentary exercise of a limited power of appointment with respect to the domestic trust. Treasury and the IRS believe that, under general principles regarding limited powers of appointment, the domestic trust, and not the holder of the limited power of appointment, is the transferor of the property. Accordingly, the domestic trust must recognize gain under the general rule of §1.684–1(a) unless an exception applies. The final regulations do not include any special rules for such transfers.

One commenter asked about the interaction of §1.684–2(d) and §1.684–2(e) in the context of an actual transfer of property from a foreign trust that is treated as owned by a U.S. person to either a foreign charitable organization or a U.S. charity. Under §1.684–2(d) of the proposed regulations, 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. Under §1.684–2(e) of the proposed regulations, if a portion of a foreign trust that is treated as owned by a U.S. person ceases to be treated as owned by the U.S. person, the U.S. person is treated as having transferred the assets of that portion of the trust to a foreign trust immediately before such portion is no longer treated as owned by the U.S. person.

The commenter noted that §1.684–2(e) of the proposed regulation could be read to apply in situations where a portion of a

foreign trust ceases to be treated as owned by a U.S. person because of an actual transfer of property from the trust. The final regulations clarify that §1.684–2(e) does not apply (and that §1.684–2(d) may apply) when any portion of a trust ceases to be owned by a U.S. person by reason of an actual transfer of property from the trust. As a result, the general rule of gain recognition under §1.684–1(a) would not apply to an actual transfer by a foreign trust that is treated as owned by a U.S. person to a foreign charitable trust that meets the requirements of §1.684–3(b), or to a U.S. charity, even if the transfer causes the portion of the trust to cease to be owned by the U.S. person.

III. *Comments and Changes to §1.684–3: Exceptions to the General Rule of Gain Recognition*

Section 1.684–3(a) of the proposed regulations provides that a U.S. person who transfers property to a foreign trust is not required to recognize gain on the transfer to the extent that any person is treated as the owner of the trust under section 671. One commenter questioned whether the term *any person* includes foreign persons. Although not specifically addressed in the final regulations, it is understood that the term *any person* includes foreign as well as U.S. persons.

Section 1.684–3(b) of the proposed regulations provides an exception for transfers to a foreign trust that has already received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3), provided that the letter has been neither revoked nor modified. Commenters questioned the requirement that a foreign trust obtain a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). They assert that the requirement may interfere with a U.S. person's ability to make contributions to a foreign charitable entity that may not be familiar with U.S. tax laws and may not have any reason to obtain a determination letter from the IRS. They suggest that the final regulations require only that the U.S. transferor disclose to the IRS, at such time and in such manner as the IRS may provide, that the transfer has been made and that the U.S. transferor believes the transferee is an organization described in section 501(c)(3).

In response to commenters' concerns, the final regulations eliminate the requirement that the foreign trust receive a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). The final regulations provide, instead, that the general rule of gain recognition does not apply to any transfer of property to a foreign trust that is described in section 501(c)(3) (without regard to the requirements of section 508(a)). However, taxpayers should be aware that, under Notice 97–34 (1997–1 C.B. 422), the U.S. transferor has a reporting obligation on Form 3520 with respect to such a transfer, unless the foreign trust has received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). Moreover, if the IRS subsequently determines that the foreign trust is not described in section 501(c)(3), the exception will not apply and the U.S. transferor will be required to recognize gain as of the time of the original transfer, and may be subject to interest and penalties, if applicable.

Section 1.684–3(c) of the proposed regulations provides an exception for transfers of property by reason of the death of the U.S. transferor if both of the following requirements are satisfied: (1) the property is included in the U.S. transferor's gross estate for Federal estate tax purposes, and (2) the basis of the property in the hands of the foreign trust is determined under section 1014(a). One commenter questioned whether section 684 would apply in the case of an individual who is a U.S. person for income tax purposes, but a non-domiciliary for estate tax purposes, with the result that the property of the individual would be entitled to a step-up in basis, but would not be included in the individual's gross estate. The final regulations eliminate the requirement that the property be included in the U.S. transferor's gross estate and allow the exception to apply as long as the basis of the property in the hands of the foreign trust is determined under section 1014(a).

Another commenter requested that the final regulations confirm that section 1032 applies to provide for nonrecognition of gain on issuer stock transferred to a foreign trust. The commenter noted that under former section 1491, no excise tax was imposed on a transfer of stock by a foreign corporation to a foreign trust if the corporation was not required to recognize gain on the transfer under section 1032. See Notice 97–18 (1997–1 C.B. 389, Sec. II.A.1). In response to this comment, §1.684–3(e) of the final regulations provides a new exception for transfers of stock (including treasury stock) by a domestic corporation to a foreign trust if the domestic corporation is not required to recognize gain on the transfer under section 1032.

Commenters also suggested that contributions by U.S. persons to foreign compensatory trusts described in sections 402(b), 404(a)(4), or 404A should be exempt from gain recognition under section 684. Treasury and the IRS have considered the proposed exception but do not believe it is consistent with the intended purpose of section 684. Accordingly, the final regulations do not include an exception for transfers to foreign compensatory trusts. However, the exception for transfers of stock to which section 1032 would apply may be available in appropriate cases for transfers of stock of a domestic parent company to a foreign compensatory trust set up by a foreign subsidiary.

Another commenter requested an exception for transfers of life insurance contracts to foreign trusts. The commenter noted that the proceeds of life insurance contracts do not generally give rise to any taxable gain if held by a U.S. individual or trust. Congress has recognized that life insurance contracts might be used to effectuate inappropriate outbound transfers of property. As part of the repeal of section 1491 in 1997, Congress enacted section 1035(c), which provides regulatory authority to deny the nonrecognition treatment given to exchanges of life insurance contracts under section 1035(a) where the exchange has the effect of transferring property to any person other than a U.S. person. Public Law 105–34, §1131(b)[(c)](1). Because of the potential for abuse and the lack of a compelling reason for creating an exception for offshore transfers of life insurance contracts, Treasury and the IRS have concluded that such an exception is not warranted.

IV. *Comments and Changes to §1.684–4: Outbound Migration of Domestic Trusts*

Section 1.684–4 of the proposed regulation provides that if a U.S. person trans-

fers 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 and the domestic trust must immediately recognize gain. The proposed regulations do, however, incorporate the relief for inadvertent migrations that is set forth in §301.7701–7(d)(2).

One commenter suggested that the final regulations should extend the inadvertent migration rules of §301.7701–7(d)(2) to apply to §301.7701–7(f), which deals with the election by certain trusts to remain domestic trusts. Under §301.7701–7(d)(2), in the event of an inadvertent change in any person that has the power to make a substantial decision of the trust that would cause the domestic or foreign residency of the trust to change (*e.g.*, an inadvertent change from a U.S. trustee to a foreign trustee by reason of the U.S. trustee's death), the trust is allowed 12 months to make necessary changes to avoid a change in the trust's residency (*e.g.*, the replacement of the foreign successor trustee with a U.S. successor trustee). The commenter suggests that a trust with an election in force under §301.7701–7(d)(2) should be allowed a similar amount of time to make necessary changes if a U.S. trustee is inadvertently replaced by a foreign trustee.

The final regulations do not include such a rule. Under §301.7701–7(f), a trust generally can elect to remain a domestic trust if it was in existence on August 20, 1996, and it was treated as a domestic trust on August 19, 1996. Section 301.7701–7(f)(4)(ii) provides that such an election terminates if subsequent changes are made to the trust that result in the trust no longer having any reasonable basis for being treated as a domestic trust under section 7701(a)(30) prior to its amendment by the Small Business Job Protection Act of 1996 (SBJP Act), Pub. L. 104–188, 110 Stat. 1755. Whereas the "control test" of section 7701(a)(30)(E)(ii), as enacted by the SBJP Act, contains a relatively bright-line test for purposes of determining a trust's status, thereby necessitating the inadvertent migration rule of §301.7701–7(d)(2), the determination of domestic or foreign status prior to the SBJP Act was governed by less objective criteria.

Under pre-SBJP Act law, an inadvertent short-term replacement of a domestic trustee by a foreign trustee would not necessarily cause a change in the trust's status. Accordingly, a specific inadvertent migration rule for §301.7701–7(f) is not appropriate. Instead, as set forth in §301.7701–7(f)(4)(ii), an election under §301.7701–7(f) will not be terminated unless the trust has no reasonable basis for being treated as a domestic trust under pre-SBJP Act law.

Special Analyses

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

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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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by 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. See also §301.7701–7 of this chapter.

(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. *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 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 paragraph (b) of this section and §1.679–3(c), *A* is treated as having transferred the property to *FT*. Under paragraph (b) of this section 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 *FT1*. At the time of the transfer, *FT1* has a U.S. beneficiary as defined in §1.679–2 and *A* is treated as the owner of *FT1* under section 679. On January 1, 2003, *FT1* 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 *FT1* to *FT2*.

(e) *Deemed 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 (other than by reason of an actual transfer of property from the trust to which §1.684–2(d) applies), the U.S. person shall be treated as having transferred, immediately before (but on the same date that) 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 as defined in §1.679–2(c) and as of that date neither *A* nor any other person is treated as owning any portion of *FT*. Pursuant to §1.679–2(c)(2), if *FT* ceases to be treated as having a U.S. beneficiary, *A* will cease to be treated as

owner of *FT* beginning on the first day of the first taxable year following the last taxable year in which there was a U.S. beneficiary. Thus, on January 1, 2004, *A* ceases to be treated as owner of *FT*. On that date, the fair market value of the property is 1200X and the adjusted basis is 350X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* on January 1, 2004, 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 is described in section 501(c)(3) (without regard to the requirements of section 508(a)).

(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 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) *Transfers to which section 1032 applies*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of stock (including treasury stock) by a domestic corporation to a foreign trust if the domestic corporation is not required to recognize gain on the transfer under section 1032.

(f) *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.

(g) *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. Transfer of property at death: Basis determined under section 1014(a). (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 because the basis of the property in the hands of the foreign trust is determined under section 1014(a).

Example 3. Transfer of property at death: Basis not determined under section 1014(a). (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* retains no power over *FT*, and *FT*'s basis in the property transferred is not determined under section 1014(a). 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). *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, and neither trust is treated as owned by any person under subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, 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 §301.7701–7(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, and *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 U.S. 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. *T* is not treated as owned by another person. *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

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

Robert E. Wenzel,
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Approved July 9, 2001.

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