

Special Analyses

It has been determined that this proposed regulation 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 these regulations do not impose on small entities a collection of information requirement, 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, 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 business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. In addition, comments are requested on the administrative difficulty and potential tax benefit or detriment of maintaining separate classes within a category when two classes are only temporarily subject to the same rate (for example, if the current rate applicable to one class sunsets in a future year). All comments will be available for public inspection and copying.

A public hearing has been scheduled for Tuesday, March 9, 2004 in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must use the main building entrance on Constitution Avenue. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written (signed original and eight (8) copies) or electronic

comments and an outline of the topics to be discussed and the time to be devoted to each topic by Tuesday, February 17, 2004. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of 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 Theresa M. Melchiorre, Office of Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 for part 1 continues to read in part as follows:

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

Par. 2. Section 1.664–1 is amended as follows:

1. Paragraph (d)(1) is revised.

2. Paragraph (d)(2) is amended by:

a. Removing the language “or to corpus (determined under subparagraph (1)(i) of this paragraph)” in the first sentence and adding “(determined under paragraph (d)(1)(i)(a) of this section) or to corpus” in its place.

b. Removing the language “subparagraph (1)(i)(c) of this paragraph” from the fifth sentence and adding “paragraph (d)(1)(i)(a)(3) of this section” in its place.

c. Removing the language “or corpus in the categories described in subparagraph (1) of this paragraph” from the last sentence and adding “described in paragraph (d)(1)(i)(a) of this section or to corpus” in its place.

3. Paragraph (e)(1) is amended by removing the language “paragraph (d)(1)” from the first sentence and adding “paragraph (d)(1)(i)(a)” in its place.

The revision reads as follows:

§ 1.664–1 Charitable remainder trusts.

* * * * *

(d) *Treatment of annual distributions to recipients*—(1) *Character of distributions*—(i) *Assignment of income to categories and classes.* (a) A trust's income, including income includible in

gross income and other income, is assigned to one of three categories in the year in which it is required to be taken into account by the trust. These categories are—

(1) Gross income, other than gains and amounts treated as gains from the sale or other disposition of capital assets (referred to as the ordinary income category);

(2) Gains and amounts treated as gains from the sale or other disposition of capital assets (referred to as the capital gains category); and

(3) Other income (including income excluded under part III, subchapter B, chapter 1, subtitle A of the Internal Revenue Code).

(b) Items within the ordinary income and capital gains categories are assigned to different classes based on the Federal income tax rate applicable to each type of income in that category in the year the items are required to be taken into account by the trust. For example, the ordinary income category may include a class of qualified dividend income as defined in section 1(h)(11) and a class of all other ordinary income. In addition, the capital gains category may include separate classes for short-term capital gains and losses, for 28-percent rate gain as defined in section 1(h)(4), for unrecaptured section 1250 gain as defined in section 1(h)(6), and for all other long-term capital gains and losses. After items are assigned to a class, the tax rates may change so that items in two or more classes would be taxed at the same rate if distributed during a particular year. If the changes to the tax rates are permanent, the undistributed items in those classes are combined into one class. If, however, the changes to the tax rates are only temporary (for example, the new rate for one class will sunset in a future year), the classes are kept separate.

(i) *Order of distributions.* (a) The categories and classes of income (determined under paragraph (d)(1)(i) of this section) are used to determine the character of an annuity or unitrust distribution from the trust in the hands of the recipient irrespective of whether the trust is exempt from taxation under section 664(c) for the year of the distribution. The determination of the character of amounts distributed shall be made as of the end of the taxable year of the trust. The recipient is taxed on the distribution based on the tax rates applicable in the year of the distribution to the classes of income that are deemed distributed from the trust. The character of the distribution in the hands of the annuity or unitrust recipient is determined by treating the distribution