

on his return for the taxable year 1954. The balance of the capital loss carryover of \$5,000 may be carried over only to the years 1955 and 1956, in accordance with paragraph (a) of § 1.1212-1 and the rules of this section.

Example 2. A trust distributes all of its assets, one-half to A, an individual, and one-half to X, a corporation, who are the sole remaindermen, and terminates on December 31, 1966, when it has a short-term capital loss carryover of \$20,000 attributable to short-term transactions during the taxable years 1964, 1965, and 1966, and a long-term capital loss carryover of \$12,000 attributable to long-term transactions during such years. A, who reports on the calendar year basis, otherwise has ordinary income of \$15,000, short-term capital gains of \$4,000 and long-term capital gains of \$6,000, for the taxable year 1966. A would offset his short-term capital gains of \$4,000 against his share of the short-term capital loss carryover of the trust, \$10,000 (one-half of \$20,000), and, in addition deduct under section 1211(b) \$1,000 (treated as a short-term gain for purposes of computing capital loss carryovers) on his return for the taxable year 1966. A would also offset his long-term capital gains of \$6,000 against his share of the long-term capital loss carryover of the trust, \$6,000 (one-half of \$12,000). The balance of A's share of the short-term capital loss carryover, \$5,000, may be carried over as a short-term capital loss carryover to the succeeding taxable year and treated as a short-term capital loss incurred in such succeeding taxable year in accordance with paragraph (b) of § 1.1212-1. X, which also reports on the calendar year basis, otherwise has capital gains of \$4,000 for the taxable year 1966. X would offset its capital gains of \$4,000 against its share of the capital loss carryovers of the trust, \$16,000 (the sum of one-half of each the short-term carryover and the long-term carryover of the trust), on its return for the taxable year 1966. The balance of X's share, \$12,000, may be carried over as a short-term capital loss only to the years 1967, 1968, 1969, and 1970, in accordance with paragraph (a) of § 1.1212-1 and the rules of this section.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 6828, 30 FR 7805, June 17, 1965; T.D. 7564, 43 FR 40495, Sept. 12, 1978]

§ 1.642(h)-2 Excess deductions on termination of an estate or trust.

(a) If, on the termination of an estate or trust, the estate or trust has for its last taxable year deductions (other than the deductions allowed under section 642(b) (relating to personal exemption) or section 642(c) (relating to charitable contributions)) in excess of gross income, the excess is allowed under section 642(h)(2) as a deduction to the

beneficiaries succeeding to the property of the estate or trust. The deduction is allowed only in computing taxable income and must be taken into account in computing the items of tax preference of the beneficiary; it is not allowed in computing adjusted gross income. The deduction is allowable only in the taxable year of the beneficiary in which or with which the estate or trust terminates, whether the year of termination of the estate or trust is of normal duration or is a short taxable year. For example: Assume that a trust distributes all of its assets to B and terminates on December 31, 1954. As of that date it has excess deductions, for example, because of corpus commissions on termination, of \$18,000. B, who reported on the calendar year basis, could claim the \$18,000 as a deduction for the taxable year 1954. However, if the deduction (when added to his other deductions) exceeds his gross income, the excess may not be carried over to the year 1955 or subsequent years.

(b) A deduction based upon a net operating loss carryover will never be allowed to beneficiaries under both paragraphs (1) and (2) of section 642(h). Accordingly, a net operating loss deduction which is allowable to beneficiaries succeeding to the property of the estate or trust under the provisions of paragraph (1) of section 642(h) cannot also be considered a deduction for purposes of paragraph (2) of section 642(h) and paragraph (a) of this section. However, if the last taxable year of the estate or trust is the last year in which a deduction on account of a net operating loss may be taken, the deduction, to the extent not absorbed in that taxable year by the estate or trust, is considered an "excess deduction" under section 642(h)(2) and paragraph (a) of this section.

(c) Any item of income or deduction, or any part thereof, which is taken into account in determining the net operating loss or capital loss carryover of the estate or trust for its last taxable year shall not be taken into account again in determining excess deductions on termination of the trust or estate within the meaning of section 642(h)(2)

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and paragraph (a) of this section (see example in § 1.642(h)-5).

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7564, 43 FR 40495, Sept. 12, 1978]

§ 1.642(h)-3 Meaning of “beneficiaries succeeding to the property of the estate or trust”.

(a) The phrase *beneficiaries succeeding to the property of the estate or trust* means those beneficiaries upon termination of the estate or trust who bear the burden of any loss for which a carryover is allowed, or of any excess of deductions over gross income for which a deduction is allowed, under section 642(h).

(b) With reference to an intestate estate, the phrase means the heirs and next of kin to whom the estate is distributed, or if the estate is insolvent, to whom it would have been distributed if it had not been insolvent. If a decedent's spouse is entitled to a specified dollar amount of property before any distribution to other heirs and next of kin, and if the estate is less than that amount, the spouse is the beneficiary succeeding to the property of the estate or trust to the extent of the deficiency in amount.

(c) In the case of a testate estate, the phrase normally means the residuary beneficiaries (including a residuary trust), and not specific legatees or devisees, pecuniary legatees, or other nonresiduary beneficiaries. However, the phrase does not include the recipient of a specific sum of money even though it is payable out of the residue, except to the extent that it is not payable in full. On the other hand, the phrase includes a beneficiary (including a trust) who is not strictly a residuary beneficiary but whose devise or bequest is determined by the value of the decedent's estate as reduced by the loss or deductions in question. Thus the phrase includes:

(1) A beneficiary of a fraction of a decedent's net estate after payment of debts, expenses, etc.;

(2) A nonresiduary legatee or devisee, to the extent of any deficiency in his legacy or devise resulting from the insufficiency of the estate to satisfy it in full;

(3) A surviving spouse receiving a fractional share of an estate in fee under a statutory right of election, to the extent that the loss or deductions are taken into account in determining the share. However, the phrase does not include a recipient of dower or curtesy, or any income beneficiary of the estate or trust from which the loss or excess deduction is carried over.

(d) The principles discussed in paragraph (c) of this section are equally applicable to trust beneficiaries. A remainderman who receives all or a fractional share of the property of a trust as a result of the final termination of the trust is a beneficiary succeeding to the property of the trust. For example, if property is transferred to pay the income to A for life and then to pay \$10,000 to B and distribute the balance of the trust corpus to C, C and not B is considered to be the succeeding beneficiary except to the extent that the trust corpus is insufficient to pay B \$10,000.

§ 1.642(h)-4 Allocation.

The carryovers and excess deductions to which section 642(h) applies are allocated among the beneficiaries succeeding to the property of an estate or trust (see § 1.642(h)-3) proportionately according to the share of each in the burden of the loss or deductions. A person who qualified as a beneficiary succeeding to the property of an estate or trust with respect to one amount and does not qualify with respect to another amount is a beneficiary succeeding to the property of the estate or trust as to the amount with respect to which he qualifies. The application of this section may be illustrated by the following example:

Example. A decedent's will leaves \$100,000 to A, and the residue of his estate equally to B and C. His estate is sufficient to pay only \$90,000 to A, and nothing to B and C. There is an excess of deductions over gross income for the last taxable year of the estate or trust of \$5,000, and a capital loss carryover of \$15,000, to both of which section 642(h) applies. A is a beneficiary succeeding to the property of the estate to the extent of \$10,000, and since the total of the excess of deductions and the loss carryover is \$20,000, A is entitled to the benefit of one half of each item, and the remaining half is divided equally between B and C.