NEW YORK CITY BAR

REPORT BY THE ESTATE AND GIFT TAXATION COMMITTEE

RECOMMENDATION TO CLARIFY SECTION 672(e) OF THE INTERNAL REVENUE CODE, THE "SPOUSAL UNITY" RULE

The Estate and Gift Taxation Committee of the New York City Bar Association (the "Committee") recommends that Congress and/or the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "IRS") clarify the effect of Section 672(e) of the Internal Revenue Code of 1986, as amended (the "Code"). In particular, the Committee believes new legislation and/or a new regulation is necessary to clarify that the "spousal unity" rule under Section 672(e) is not applicable in the event of a divorce or legal separation.[1] Accompanying this Report is an Appendix with (i) the Committee's proposed language for a recommended amendment to Section 672(e) of the Code and a redline document showing the changes from the current Section 672(e) and (ii) the Committee's proposed language for a recommended regulation.

I. BACKGROUND

Part I of Subchapter J of the Code deals with the income taxation of trusts. The potential income tax consequences for the grantor of a trust are addressed in Subpart E of Subchapter J of the Code. When Subpart E applies to the grantor of a trust, the grantor is treated under § 671 as the owner of a portion or all of a trust and takes into account in computing his or her income tax

[1] The following Report is based in large part on the comments submitted by The American College of Trust and Estate Counsel ("ACTEC") on July 2, 2018 regarding the application of various Code sections after the repeal of Section 682 and a recommendation for regulatory guidance from the Internal Revenue Service https://www.actec.org/wp-content/uploads/2023/08/Notice_2018-37_Comments_on_guidance_in_connection_with_the_Repeal_of_Section_682.pdf. (all websites last accessed Nov. 10, 2025) Additionally the section of the Report addressing the potential unconstitutionality of the spousal unity rule is based in large part on the article authored by Austin Bramwell and Leah Socash, titled The Spousal Unity Rule: An Unconstitutional Trigger of Grantor Trust Tax, published in *Tax Notes Federal* (September 22, 2025), a copy of which may be found at https://www.milbank.com/a/web/tkGHUWvESEeRHARyeaJq83/aRnmHN/the-spousal-unity-rule-an-unconstitutional-trigger-of-grantor-trust-tax-9222025.pdf. The Committee wishes to express its thanks to ACTEC, Austin Bramwell and Leah Socash for their thoughtful contributions to this topic. In light of the passage of time, the continued relevance of the matter and the recommendations herein to utilize a statutory amendment and/or new regulation to clarify the matter, the Committee thought it worthwhile to revisit the issue.

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The mission of the New York City Bar Association, which was founded in 1870 and has over 20,000 members, is to equip and mobilize a diverse legal profession to practice with excellence, promote reform of the law, and uphold the rule of law and access to justice in support of a fair society and the public interest in our community, our nation, and throughout the world.

all of the income, deductions, and credits that are attributable to the portion of the trust treated as owned by him or her.[2]

Code § 682

Section 11051 of the Tax Cuts and Jobs Act of 2017 (the "2017 Act") repealed § 682, effective for taxpayers whose divorce or separation instruments are executed after December 31, 2018. As in effect prior to the 2017 Act, § 682 provided rules describing how the income[3] of a trust is taxed if it is payable to a spouse or a former spouse of the trust's grantor from whom the taxpayer is divorced or legally separated under a decree of divorce or separate maintenance or under a written separation agreement.[4] Under § 682 this income was includible in the gross income of the grantor's former spouse and was not includible in the grantor's gross income, despite any other provision of Subtitle A of the Code, including the normal rules of Subpart E.[5]

Code § 682(b) also applied for purposes of computing the taxable income of the trust and the taxable income of the grantor's former spouse to whom § 682(a) applied. It provided that the grantor's former spouse was considered the beneficiary of the trust for purposes of Part I of Subchapter J (§§ 641-685).

The predecessor of § 682 was § 171 of the Internal Revenue Code of 1939 (the "1939 Code"). § 171 entered the 1939 Code as part of the Revenue Act of 1942. The 1939 Code also provided an income tax deduction for the periodic payments a husband made to his wife under a decree of divorce or separate maintenance in discharge of a legal obligation imposed on him because of the marital relationship ("alimony"). It required the wife to include the alimony payments in her gross income.[6]

The alimony inclusion provision, § 22(k) of the 1939 Code, also required a wife who received periodic payments attributable to property transferred in trust or otherwise to include those payments received in her gross income if the property was transferred in discharge of an obligation imposed on the husband on account of the marital relationship. Payments so included would be excluded from the gross income of the husband.

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[2] A trust that is treated as owned by its grantor is generally referred to as a "grantor trust." Subpart E, § 678 also treats some trust beneficiaries who have or had unilateral withdrawal rights over trust property as the owner of a portion or all of a trust. The issues discussed in this Report could affect these beneficiaries in a manner similar to the way they affect grantors. For convenience, this Report refers to any affected taxpayer as the "grantor" of the trust.

[3] For purposes of Subpart E of Subchapter J, Treas. Reg. § 1.671-2(b) provides that "income" means taxable income and not only income for fiduciary accounting purposes. It is unclear what the term income means for purposes of former § 682, which was in Subpart F of Subchapter J.

[4] References in this Report to "former spouse" include existing spouses from whom the grantor is separated under a decree of legal separation.

[5] Treas. Reg. § 1.682(a)-1(a)(1) provides "under section 682(a) income of a trust— (i) [w]hich is paid, credited, or required to be distributed to the wife in a taxable year of the wife, and (ii) [w]hich, except for the provisions of section 682, would be includible in the gross income of her husband, is includible in her gross income and is not includible in his gross income."

[6] 1939 Code §§ 22(k) and 23(u). The 1939 Code referred to the payor of alimony as the husband and the recipient as the wife because in 1939 the obligation to make alimony payments was imposed only on the husband.

The narrow purpose of § 171 was to effectively treat a husband who had created (or was the beneficiary of) a trust *before* his divorce or separation that was used to make payments to his former wife the same as a husband who created a trust *in connection with* his divorce would be treated under § 22(k).[7] Section 171 required a wife who was divorced or legally separated from her husband under a decree of divorce or separate maintenance to include in her gross income the amount of income paid to her from any trust that, in the absence of § 171, would have been taxable to the husband. It also provided that the husband could exclude this income from his gross income whether or not the income would ordinarily be taxable to him under §§ 166 or 167 of the 1939 Code or any other provisions of the income tax law.

Sections 166 and 167 were the only provisions of the grantor trust rules that were in existence in 1942. Section 166 was the predecessor of current § 676. Section 167 was the predecessor of § 677. In 1942, neither of these sections was triggered by the existence of an interest in or power over a trust in a grantor's spouse. Each of these sections is discussed more fully below.

Sections 22(k), 23(u) and 171 were imported into the Internal Revenue Code of 1954 (the "1954 Code") as §§ 71, 215, and 682. The scope of these sections was changed in 1986. One of the changes to § 71 eliminated the requirement that a spouse include in his or her gross income periodic payments from property transferred in discharge of an obligation imposed on the other spouse on account of the marital relationship. It also eliminated the exclusion from gross income that benefitted the other spouse. But § 682 was left in place to fill the gap. Until its repeal, § 682 protected a spouse who would otherwise be taxed on trust income under the grantor trust rules or otherwise from taxation to the extent trust income was payable to his or her former spouse.

Code § 672(e)(1)(A): The Spousal Unity Rule

Subpart E of Subchapter J of the 1954 Code, as originally enacted, referred to the grantor's spouse in only two provisions. Section 672(c) provided that the term "related or subordinate party" includes any nonadverse party who is the ***grantor's spouse if living with the grantor***. Section 674(d) addresses the power to control the beneficial enjoyment of the corpus or the income of a trust held by trustees none of whom is the grantor ***or spouse living with the grantor***, if the power is limited by a reasonably definite external standard. As described below, amendments to the Code in 1969 and 1986 expanded the circumstances in which the possession of an interest or power by the grantor's spouse triggered the grantor trust rules.

Section 672(e)(1)(A) (the "spousal unity rule") currently provides that, for purposes of Subpart E of Subchapter J, a grantor is treated as holding any power or interest held by any individual who was the grantor's spouse at the time of the creation of the power or interest. As originally enacted by the Tax Reform Act of 1986, the text of § 672(e) was as follows:

> (e) Grantor Treated as Holding Any Power or Interest of Grantor's Spouse.—For purposes of this subpart, if a grantor's spouse is living with the grantor at the time of the creation of any power or

[7] J. Seidman, Legislative History of Federal Income Tax and Excess Profits Tax Laws 1953-1939, 1275-85 (1954).

interest held by such spouse, the grantor shall be treated as holding such power or interest.

The Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act") changed the scope of § 672(e) by providing that the spousal unity rule also applies (1) to any power or interest held by an individual who became the spouse of a grantor after the creation of the power or interest (but only after the marriage), and (2) whether or not the grantor and his or her spouse were living together at the time of the creation of the power or interest. The amendment also provided that the rule does not apply to any power or interest created in the spouse if, at the time of the creation of the power or interest, they are legally separated under a decree of divorce or of separate maintenance.

There are a number of provisions in Subpart E the operation of which depend on whether a particular individual is the grantor's spouse. The impact of § 672(e) on the application of many of these provisions when that individual is the grantor's former spouse has long been unclear. Section 672(e) itself says nothing about the termination of the spousal unity rule if the spouses divorce or legally separate after the creation of the power or interest. Section 672(e)(1)(A) does, however, provide that the spousal unity rule begins if a person becomes the spouse of a grantor after the creation of the power or interest.

Some commentators believe that § 672(e)(1)(A) is applicable in any situation in which a grantor is treated as the owner of a portion of a trust in Subpart E of Subchapter J on account of a spousal interest or power, even following divorce. The support for this belief is the failure of § 672(e) to address directly the question of whether the spousal unity rule ends when the marriage ends.[8]

The 1988 Act amended two other provisions of Subpart E, §§ 674(c) and 675(3). Section 674(c) addresses the power to control the beneficial enjoyment of the corpus or the income of a trust held by trustees when "none of whom is the grantor." Section 675(3) addresses situations in which the grantor has borrowed the corpus or income of a trust and has not completely repaid the loan before the beginning of the taxable year.

The 1988 Act added a sentence to the end of both § 674(c) and § 675(3) providing that "[f]or periods during which an individual is the spouse of the grantor (within the meaning of section 672(e)(2)), any reference in this subsection to the grantor shall be treated as including a reference to such individual." With respect to § 674(c), this language suggests that the spousal unity rule should apply only if the spouses are married during the period of time the grantor's spouse is serving as a trustee. However, as discussed below, § 672(e) could be applied in a manner inconsistent with the sentence added by the 1988 Act. The statutes do not resolve this apparent inconsistency.

As noted above, § 674(d) addresses a power to control the beneficial enjoyment of trust income or principal held by trustees none of whom is the grantor or grantor's spouse **living with the grantor**, if the power is limited by a reasonably definite external standard. This provision has

[8] Professor Jeffrey N. Pennell notes that "[c]uriously, § 672(e) does not indicate whether spousal unity ends when the marriage does." Footnote 36, Chapter 5 of Casner & Pennell, Estate Planning.

not been modified since it first became part of Subpart E in 1954 and seems to look to the marital status of a trustee at the time he or she is serving as a trustee.

It seems clear from the language added in 1988 and from § 674(d) that, if an individual is legally separated from his or her spouse under a decree of divorce or of separate maintenance (or not living together with respect to § 674(d)), the spousal unity rule should not be applied for purposes of §§ 674(c), 674(d), and 675(3). This is illustrated by the following examples.

> **Example 1**: If a power held by the grantor's spouse prevents the § 674(c) exception to grantor trust treatment under § 674(a) from applying, after the date of the grantor's divorce the fact that the grantor's former spouse continues to hold that power should no longer cause the grantor to be treated as the owner of the trust.
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> **Example 2**: If a power held by the grantor's spouse who is living with the grantor prevents the § 674(d) exception to grantor trust treatment under § 674(a) from applying, after the date of the grantor's divorce the fact that the grantor's former spouse continues to hold that power should no longer cause the grantor to be treated as the owner of the trust.
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> **Example 3**: If, after the date of the grantor's divorce, the grantor's former spouse borrows the corpus or income from a trust created by the grantor and has not completely repaid the loan before the beginning of the taxable year, the grantor should not be treated as the owner of the trust by reason of § 675(3).

Because similar amendments were not made to other provisions of Subpart E, the operation of which depend on whether a particular individual is the grantor's spouse, it is not clear whether § 672(e)(1)(A) will cause these provisions to continue to apply after the grantor and the grantor's spouse are divorced. To illustrate, consider the following examples:

> **Example 4**: Code § 673 treats the grantor as the owner of any portion of a trust in which the grantor has a reversionary interest in either the corpus or the income if, at the time of the transfer to the trust, the reversionary interest has a value exceeding 5% of the value of the portion that may revert. Because of § 672(e)(1)(A), if the grantor's spouse has a remainder interest in the trust that exceeds 5% of the value of the trust at the time of the transfer to the trust the grantor will be treated as the owner of the trust.[9] Will grantor trust status continue if the grantor and the grantor's spouse are divorced?
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> **Example 5**: Code §§ 674(a), 675(1) and (2), 676(a), and 677(a) treat the grantor as the owner of any portion of a trust if the grantor or a non-adverse party (or both) have a certain power described in those sections. Because of § 672(e)(1)(A), a power described in each of these sections held by the grantor's spouse will trigger grantor trust status whether or not the grantor's spouse has an adverse interest. Will this status continue if the grantor and the grantor's spouse are divorced?

[9] In his treatise, Federal Income Taxation of Estates, Trusts, and Beneficiaries, Professor Mark L. Ascher notes that § 672(e) was enacted in 1986 to curtail the use of "spousal remainder trusts." A spousal remainder trust pays trust income to a beneficiary (e.g., the grantor's child) for a term of years and, at the end of the term, the remainder passes to the grantor's spouse.

Example 6: Code § 674(b)(3), (c), and (d) contain exceptions to the rule creating grantor trust status when nonadverse parties hold a power to alter the beneficial enjoyment of trust property. These exceptions apply for certain powers held by persons other than the grantor. Because of § 672(e)(1)(A), a power held by the grantor's spouse described in one of these sections will be treated as held by the grantor. Will this status continue if the grantor and the grantor's spouse are divorced? In the case of § 674(c) and (d), explicit language limiting the exception to "periods during which the individual is a spouse of the grantor" or periods when the individual is living with the grantor suggest that the spousal unity rule should not apply.

Example 7: Code § 677 treats the grantor of a trust as its owner if the grantor or any person other than an adverse party has the power to distribute income to or accumulate income for future distribution to the grantor or the grantor's spouse. Similarly, § 676 treats the grantor of a trust as its owner if the grantor or any person other than an adverse party has the power to revest title to trust property in the grantor. If the possibility that trust income might be distributed to an individual or that title to trust property might be revested in that individual is treated as an interest in the trust, § 672(e) could cause a trust the income or principal of which is payable or potentially payable to a grantor's former spouse to be treated as owned by the grantor if the grantor was married to the former spouse at any time that the power existed.

II. LEGISLATIVE HISTORY, PUBLIC POLICY AND THE IMPACT OF THE REPEAL OF CODE § 682

Prior to 1986, if a grantor's spouse held a reversionary interest in the trust, the trust was not treated as a grantor trust under Subpart E, because the grantor did not directly hold a reversion in the trust. The General Explanation of the 1986 Act provides: "many tax practitioners took the position that the application of the prior law grantor trust provisions could be avoided by having the prohibited powers or interests become effective in the spouse of the grantor (e.g., the spousal remainder trust)." The intent of 672(e) was to close a perceived loophole that would allow a grantor to avoid grantor trust treatment by giving the interests or powers of the grantor to his or her spouse.

The language did not address a subsequent separation of the grantor and his or her spouse after the interest was created. Following a divorce, however, the grantor would no longer have benefits or control over trust assets through his or her spouse and it is inconsistent with the intent of Section 672(e), as reflected in the legislative history, to apply the spousal unity rule in that context.

As a general rule, Section 7703(a)(1) provides that persons are married based on their status at the close of a taxable year. Moreover, the income tax as an annual, recurring tax supports determining this treatment annually. The application of the spousal unity rule following a divorce or legal separation is inconsistent with the general rules of the Code and creates an unusual result under Section 672(e) that does not appear to have been intended.

This provision is especially problematic in view of the repeal of Section 682. As described above, until its repeal, § 682 protected a spouse who would otherwise be taxed on trust

income under the grantor trust rules or otherwise from taxation to the extent trust income was payable to his or her former spouse. Section 682, in effect, overrode the grantor trust rules in Subpart E of Subchapter J (§§ 671-679) and established different rules for the treatment of distributions from grantor trusts to the grantor's former spouse that some believe might have been taxed to the grantor under §§ 676 or 677 because of the application of § 672(e)(1)(A). Now that, with the repeal of Section 682, the income of a trust may be taxed to the grantor even if actually distributed to his or her former spouse, the existing problems with the other provisions of Subpart E that apply when a grantor's former spouse has an interest in the trust have become exacerbated.

The 2017 Act repealed § 682, as well as § 215, the section that permitted a taxpayer to deduct his or her alimony payments made to the other spouse. One of the conforming amendments to the repeal of the alimony deduction was the repeal of § 71, the section that required the recipient of alimony payments to include the payments in gross income. The 2017 Act described the repeal of § 682 as an additional conforming amendment to the repeal of § 215.

Given the original purpose of § 682, its repeal in connection with the repeal of the alimony deduction is not surprising. Section 682 was originally intended to protect a grantor from a requirement to include trust income payable to his former wife in his gross income if the trust principal or income could revert to him within the meaning of current §§ 676 or 677. But the scope of the grantor trust rules in Subpart E has expanded substantially since 1942. As a result, the role of § 682 had become more robust. Under current law, the grantor trust rules apply to a trust not only when trust income can be used for the benefit of the grantor, but also when the income can be used for the benefit of the grantor's spouse and when the grantor, the grantor's spouse, or certain other individuals have specific controls over the trust.

The application of § 682 to trusts that make payments to the grantor's former spouse eliminated some of the need to determine whether the spousal unity rule under § 672(e) continues to apply to a grantor's spouse after a divorce by protecting the grantor from gross income inclusion when trust income was payable to a former spouse. As such, the repeal of § 682 further highlights the importance of clarifying the consequences of a grantor's divorce or legal separation for purposes of applying these provisions of the grantor trust rules under Subpart E of Subchapter J and the continued application of the spousal unity rule.

III. POTENTIAL UNCONSTITUTIONALITY OF THE APPLICATION OF THE SPOUSAL UNITY RULE FOLLOWING A DIVORCE OR LEGAL SEPARATION

In light of the Supreme Court's recent decision in *Moore v. United States*,[10] there is a strong argument that the application of the spousal unity rule following a divorce or legal separation may not only have been unintended by Congress, but that such application may actually be unconstitutional. In *Moore*, the Supreme Court considered whether Congress could attribute income realized by a corporation to its shareholders. The Court ultimately determined that Congress does have broad powers to attribute corporate income in this way, but noted that the Fifth Amendment's due process clause "proscribes arbitrary attributions."[11] While the Court

[10] 602 U.S. 572 (2024).

[11] *Id.* at 599.

did not go into great detail as to what attributions would be considered arbitrary, three main sources of guidance on this topic may be gleaned from the Court's majority opinion.

First, *Moore* announces, as a "clear rule" established by court precedent, that Congress may attribute the undistributed income of a business entity to its owners, at least when the entity has not itself been taxed on the same income.[12] This ruling clearly does not apply to the attribution of income to a grantor under the spousal unity rule, but even if one were to attempt to analogize a corporate entity to a trust, this would suggest that Congress may tax either the trust (as the entity) or its beneficiaries (as the beneficial owners), but not the grantor.

Second, *Moore* indicates, albeit somewhat obliquely, that *Burnet v. Wells*[13] supplies the test for determining whether an attribution by Congress is arbitrary. In *Wells,* the Court held that it was constitutional for Congress to attribute the income of certain irrevocable trusts to the grantor of the trusts where the trusts were created for the benefit of the grantor's descendants and soon-to-be wife and were to be funded with life insurance policies on the grantor's life.[14] There, although the grantor did not own or control the trust income, the court found that the trust income benefited the grantor in that it was used to satisfy his "pressing social duty" to provide life insurance for his family.[15] Unlike in *Wells*, in a divorce situation, there is no privilege or benefit that the grantor retains from an irrevocable trust that continues for the benefit of the grantor's ex-spouse to justify attribution.

Third, in its decision in *Moore,* the Court gave "great weight" to Congress's "long settled and established practice" of attributing corporate income to its shareholders.[16] Further, part of the Court's deference to Congress was the Court's admitted reluctance to trigger a "fiscal calamity" by rendering large swaths of the Code unconstitutional.[17] Unlike with the facts in *Moore*, there is no long-settled and established practice of attributing income of a trust for the benefit of an ex-spouse to the grantor of the trust. While Section 672(e) was first enacted in 1986, as explained above, its effect was severely limited until the repeal of Section 682. In fact, Congress has consistently sought to prevent the tax system from interfering with the divorce process. For example, Section 2516 permits transfers to be made under a marital settlement agreement without risk of gift tax; similarly, Section 1041 prevents gain recognition on transfers of property incident to divorce. Additionally, issuing new legislation and/or a regulation clarifying that the spousal unity rule should not be applied as to ex-spouses would not cause any loss of revenue, as any income no longer attributed to a grantor could be collected instead from the relevant trust or beneficiaries under the general rules of trust taxation set forth in Sections 651-662 of the Code.

Moreover, while not focused on by the majority decision in *Moore*, Justice Barrett observed in her concurrence that the Supreme Court case of *Hoeper v. Tax Commission of*

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[12] *Id.* at 586.

[13] 289 U.S. 670 (1933).

[14] *Id.* at 673-674, 682.

[15] *Id.* at 681.

[16] *Moore,* 602 U.S. at 592.

[17] *Id.* at 597.

Wisconsin[18] is also relevant in reviewing Congress's powers to attribute income. In *Hoeper*, the Court held that a state statute that taxed each spouse on the combined average income of the married couple to be unconstitutional under the Fourteenth Amendment's due process clause.[19] In so holding, the Court focused on the fact that, under state law, the wife's property was considered her separate property.[20] If, under *Hoeper*, it is unconstitutional to tax one spouse on the other spouse's separate property income, then certainly it should be unconstitutional to tax a former spouse on the income of a trust for the benefit of the other former spouse.

Finally, while not adopted by the majority decision, the government in *Moore* suggested three factors for determining the arbitrariness of attribution: (1) whether the taxpayer has power and control over the income, (2) whether the taxpayer derives a privilege or benefit from the income, and (3) whether the income accumulates offshore.[21] Taken one at a time, the spousal unity rule causes attribution of income even if the grantor retains no power or control over trust income after the initial declaration of the trust terms. Next, a divorced grantor certainly does not derive a privilege or benefit from having property held in trust for an ex-spouse outside of what is required as part of a divorce settlement.[22] As for the third suggested factor, the spousal unity rule applies regardless of whether a trust is foreign or domestic or earns income offshore. The need to prevent tax avoidance or tax deferral through foreign structures therefore provides no justification for the spousal unity rule.[23] Thus, all three of the factors suggested by the government in *Moore* support the conclusion that the application of the spousal unity rule following a divorce or legal separation is arbitrary.

For all the foregoing reasons, it would not appear that Congress intended for the spousal unity rule under Section 672(e) to be applicable following a divorce or legal separation and such application may, in fact, be unconstitutional. Accordingly, clarification is needed to avoid any such application.

IV. APPLICATION OF THE SPOUSAL UNITY RULE TO SPECIFIC CODE SECTIONS

Code § 674 (c) and (d)

Code § 674(a) provides that the grantor will be treated as the owner of a portion of a trust if the beneficial enjoyment of that portion is subject to a power exercisable by the grantor or a nonadverse party without the consent of an adverse party. Application of the spousal unity rule to § 674(a) causes grantor trust status in any situation in which the grantor's spouse holds any powers that the grantor could not hold without causing grantor trust status. There are several

[18] 284 U.S. 206 (1931).

[19] *Id.* at 215-217.

[20] *Id.* at 214-215.

[21] *Id.* at 619.

[22] To the extent that a trust satisfies any obligations of the grantor as part of a divorce settlement, Section 677 will already cover any such retained interest.

[23] Other provisions in the grantor trust rules of the Code already address foreign trusts, such as Section 679.

exceptions in § 674 to the application of the rule to powers when their exercise does not require the consent of an adverse party. Code § 674(d) is one of the exceptions.

Code § 674(d) provides that § 674(a) does not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or a "spouse living with the grantor," to distribute, apportion, or accumulate income: (a) to or for a beneficiary or beneficiaries, or (b) to, for, or within a class of beneficiaries, if such power is limited in either case by a reasonably definite external standard that is set forth in the trust instrument. Whether this exception is applicable when a former spouse continues to hold a power held during marriage is unclear. The text of the provision suggests that it should not apply, at least if the grantor and the grantor's spouse are not living together. On the other hand, § 672(e) arguably operates without regard to present marital status by imputing any power held by a former spouse who held a power during marriage to the grantor. The apparent conflict between the text of §§ 674(d) and 672(e) creates an ambiguity that should be resolved.

Similarly, § 674(c) provides that § 674(a) does not apply to a power held by certain persons, none of whom is the grantor. It further provides that for periods during which an individual is the spouse of the grantor, within the meaning of § 672(e)(2), a reference to the grantor is to be treated as a reference to the spouse. Section 672(e)(2) provides that an individual legally separated from his spouse under a decree of divorce or separate maintenance shall not be considered as married. Whether the § 674(c) exception is applicable when a former spouse continues to hold a power held during marriage is unclear. Either the recommended amendment to Section 672(e) or the recommended regulation would resolve this ambiguity by providing that a power held by a former spouse will not be imputed to the grantor, including for purposes of both of the exceptions under § 674(c) and (d).

Code § 677

Code § 677(a) originally provided that the grantor would be treated as the owner of any portion of a trust if the income from that portion may, without the consent of an adverse party, be distributed to or accumulated for future distribution to the grantor.

Code § 677(a) was amended in 1969 to provide that a grantor is also treated as the owner of any portion of a trust if income from the trust may be distributed to the grantor's spouse, or accumulated for future distribution to the grantor's spouse. This provision was described by the Staff of the Joint Committee on Taxation in its general explanation as follows:

> The Act further provides that in the case of a trust created by a taxpayer for the benefit of his spouse, the trust income which may be used for the benefit of the spouse is to be taxed to the creator of the trust as it is earned. However, this provision does not apply where another provision of the Code requires the wife to include in her gross income the income from a trust.[24]

[24] JCS-16-70 at page 119.

The Treasury Regulations under § 677, which are consistent with the Joint Committee Staff explanation, state that § 677(a) affects income payable to the grantor's spouse "solely during the period of the marriage of the grantor to a beneficiary." Treas. Reg. § 1.677(a)-1(b)(2).[25]

Treas. Reg. § 1.677(a)-1(b)(2) was promulgated fifteen years prior to the enactment of § 672(e)[26] and Congress would have been aware of these regulations in 1985 and 1988. If § 672(e) is deemed to have overruled Treas. Reg. § 1.677(a)-1(b)(2), then the repeal of § 682 is likely to have serious and often unexpected consequences to divorced taxpayers who created trusts during their marriages for the benefit of now former spouses.

Moreover, § 672(e) is applicable only if the grantor's spouse holds an interest in or a power over a trust. In contrast, the operation of § 677 depends not on the possession of an interest or power by the grantor's spouse, but on the existence of another person's power to make distributions to the spouse. It is not clear, therefore, that § 672(e) was intended to apply for purposes of § 677. The recommended amendment to Section 672(e) or the recommended regulation would clarify the scope of § 672(e) and would support the application of the existing regulations under § 677, which limit the application of § 677 to income payable to the grantor's spouse during the marriage.

Code § 676

Code § 676 provides that the grantor of a trust will be treated as the owner of any portion of a trust if the grantor or a nonadverse party has the power to revest title to that portion of the trust in the grantor.

If, during the grantor's marriage, the grantor's spouse acquired the power to revest title to a portion of the trust in the grantor, § 672(e) should apply to cause the trust to be treated as a grantor trust. Moreover, after divorce, if the former spouse continues to have this power, the trust would continue to be treated as a grantor trust.

As is the case with § 677, the operation of § 676 depends on the existence of a person's power to make trust distributions to or otherwise revest title in the grantor or the grantor's spouse, not necessarily on the actual possession of any power or interest by the grantor or the grantor's spouse. Section 677's focus is on the power to distribute income while § 676's focus seems to be on the power to distribute the trust's original principal. Although an individual in whose favor a trustee can exercise such a power could be viewed as holding an interest in the trust, if this kind of power is treated as conferring an interest on the spouse for purposes of § 672(e), § 672(e) could cause § 676 to apply to a grantor because of a power of invasion exercisable in favor of a former spouse. After the repeal of § 682, trust income paid to the former spouse of a grantor would be taxed to the grantor. We believe it unlikely that this result was intended after the economic unity of the spouses is terminated with the termination of the

[25] Treas. Reg. § 1.677(a)-1(b)(2) also provides "[i]n the case of divorce or separation, see sections 71 and 682 and the regulations thereunder." This is merely a cross reference and does not mandate treatment under the Treasury Regulation as being contingent on the continued application of §§ 71 and 682.

[26] T.D. 7148, 36 FR 20749, Oct. 29, 1971, as amended by T.D. 8668.

marriage. The recommended amendment to Section 672(e) or the recommended regulation would resolve this unintended consequence by confirming that § 672(e) does not apply to a § 676 spousal interest after the grantor and the grantor's spouse are no longer spouses within the meaning of § 672(e)(2).

V. RECOMMENDATION AND CONCLUSION

For the reasons stated above, we recommend that Congress and/or the Treasury and the IRS[27] clarify the scope of Section 672(e) by issuing new legislation and/or a regulation that specifies that the spousal unity rule terminates following a decree of divorce or a legal separation, such as the recommended amendment to Section 672(e) and/or the recommended regulation which accompany this the Report.

Estate and Gift Taxation Committee
Sharon L. Klein, Chair

December 2025

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[27] The ambiguity in the current law, discussed in this Report, gives the Treasury and the IRS the authority to promulgate regulations clarifying the scope of § 672(e).

APPENDIX

PROPOSED AMENDMENTS TO IRC SECTION 672(e)

Additions are underlined, deletions struck through

(e) Grantor Treated As Holding Any Power Or Interest Of Grantor's Spouse

(1) In general

For purposes of this subpart, a grantor shall be treated as holding any power or interest held by~~—~~

~~(A)~~ any individual who ~~was~~ is the spouse of the grantor ~~at the time of the creation of such power or interest, or~~

~~(B) any individual who became the spouse of the grantor after the creation of such power or interest, but only with respect to~~ during such periods ~~after~~ when such individual ~~became~~ is the spouse of the grantor.

(2) Marital status

For purposes of paragraph (1)~~(A)~~, an individual legally separated from ~~his~~ such individual's spouse under a decree of divorce or of separate maintenance shall ~~not~~ no longer be considered as married.

Final Amended Section 672(e)

(e) Grantor Treated As Holding Any Power Or Interest Of Grantor's Spouse

(1) In general

For purposes of this subpart, a grantor shall be treated as holding any power or interest held by any individual who is the spouse of the grantor during such periods when such individual is the spouse of the grantor.

(2) Marital status

For purposes of paragraph (1), an individual legally separated from such individual's spouse under a decree of divorce or of separate maintenance shall no longer be considered as married.

RECOMMENDED TREASURY REGULATION § 1.672(E)-1

A grantor shall be treated as holding any power or interest held by any individual who is the spouse of the grantor during such periods when such individual is the spouse of the grantor. For purposes of this section, an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall no longer be considered as married.