

SENATE BILL REPORT

SB 5057

As Passed Senate, March 1, 2011

Title: An act relating to the income tax required to be paid by a trustee.

Brief Description: Concerning the income tax required to be paid by a trustee.

Sponsors: Senators Pflug, Kline and Harper; by request of Washington State Bar Association.

Brief History:

Committee Activity: Judiciary: 1/11/11, 1/18/11 [DP].

Passed Senate: 3/01/11, 43-2.

SENATE COMMITTEE ON JUDICIARY

Majority Report: Do pass.

Signed by Senators Kline, Chair; Harper, Vice Chair; Pflug, Ranking Minority Member; Carrell, Hargrove, Kohl-Welles, Regala and Roach.

Staff: Kim Johnson (786-7472)

Background: The Washington Principal and Income Act (WPIA) governs the allocation of receipts and disbursements of a trust. A trust may have different classes of beneficiaries: those that have an interest in the income (income beneficiary) and those that have an interest in the principal (remainder beneficiary). A trustee has a fiduciary duty to both kinds of beneficiaries. If a trust has two or more beneficiaries, the trustee is to act impartially among them and is to take into account the differing interests of the beneficiaries. The WPIA gives a trustee the power to reallocate or adjust receipts of the trust between or among beneficiaries.

When a trust owns an interest in what is known as a pass-through entity for income tax purposes, such as an Limited Liability Corporation (LLC), it must report its share of the entity's taxable income regardless of whether the trust actually receives all of the income. The trustee must allocate the taxes between income and principal. Because the trust's taxes and amounts distributed to a beneficiary are interrelated, the trustee may be required to apply a formula to determine the correct amount to pay to a beneficiary.

Summary of Bill: A tax required to be paid by a trustee on the trust's share of an entity's taxable income must be charged:

- to income to the extent that the receipts from the entity are allocated only to income;

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- to principal when the receipts from the entity are allocated only to principal;
- proportionately to income and principal when the receipts are allocated to both income and principal; or
- in all other cases, to principal.

Prior to determining whether to charge a tax to the principal or income, a trustee must adjust income or principal receipts by the distributions to a beneficiary for which the trust receives an income tax deduction.

Appropriation: None.

Fiscal Note: Not requested.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: I chaired a taskforce of the Real Property and Trust Section of the Washington State Bar Association which looked at this issue. The taskforce was comprised of attorneys, trustees, and CPAs. The current statute is ambiguous in that it can be interpreted in 2 different ways. We propose one of the two interpretations as a solution. The policy reason behind the interpretation we propose in this bill is that it is much more straight forward than the alternate proposal. Under the alternate proposal those trustees and income tax preparers that are not well versed in trust and income tax law may end up in trouble because it requires a much more complicated calculation that will leave the principal of the trust with just enough cash to pay the tax liability on the entire tax owed. Also, we believe that the purpose of the state Principle and Income Act is not to solve some of the intricacies of federal tax law as it applies to the state trust code. I prepared a flow chart that demonstrates the ambiguity with the current language in statute and our solution.

Persons Testifying: PRO: Marcia Fujimoto, Washington State Bar Association.