
Judiciary Committee

SSB 6597

Title: An act relating to trusts and estates.

Brief Description: Modifying trusts and estates, generally.

Sponsors: Senate Committee on Judiciary (originally sponsored by Senators Johnson, Kline, Weinstein and Esser).

Brief Summary of Substitute Bill

- Makes technical amendments to the Washington Principal and Income Act of 2002, including clarifying provisions relating to unitrusts;
- Amends the state's trust gift distribution law to decrease the likelihood that a trust will inadvertently fail to qualify for the state and federal estate tax marital deduction;
- Clarifies that a spendthrift trust beneficiary's non-exercise of certain powers does not expose the assets of the trust to creditors' claims;
- Raises from \$60,000 to \$100,000 the upper limit of so-called "small estates" that can be handled through an affidavit procedure rather than through probate;
- Makes procedural and technical changes regarding trust and estate dispute resolutions, will contests, and powers of appointment.

Hearing Date: 2/15/06

Staff: Bill Perry (786-7123).

Background:

Washington Principal and Income Act of 2002.

A trust may create different classes of beneficiaries. For instance, a trust may have an income beneficiary who is entitled to the income of the trust for his or her lifetime, and a remainder beneficiary who is entitled to the principal of the trust upon the death of the income beneficiary. A trustee of such a trust has a fiduciary duty to both kinds of beneficiaries. If a trust has two or more beneficiaries, the fiduciary is to act impartially among them and is to take into account the differing interests of the beneficiaries. Traditional rules on allocating the assets of a trust tended to maintain formal distinctions between allocating the interest and the principal of a trust. Those

traditional rules have been supplemented in recent years by acts such as the Washington Principal and Income Act of 2002. That Act gives a trustee the power to reallocate or adjust receipts of the trust between or among beneficiaries. The Act also recognizes the creation of so-called "unitrusts."

A unitrust is one in which a percentage of the assets of the trust are paid out to beneficiaries based on the net fair market value of the assets. For purposes of this calculation, it does not matter whether an individual asset of the trust would be considered principal or income for other purposes. All assets are treated the same when calculating the payout. Under the Washington Principal and Income Act of 2002, the annual payout of a unitrust is 4 percent of the net fair market value of the assets of the trust.

Marital Deduction.

Federal law allows an unlimited deduction from the federal estate tax for property left for the benefit of a surviving spouse. Some questions have arisen as to whether Washington's law on trust gift distributions is completely clear about certain gifts qualifying for the federal deduction.

Spendthrift Trusts.

Trusts under Washington law are presumptively "spendthrift," *i.e.*, the beneficiary of the trust cannot assign assets of the trust, nor borrow against them, and the assets of the trust are not available to creditors before actual distribution of assets to the beneficiary. Trusts created by a person for his or her own benefit are sometimes referred to as "self-settled" trusts.

The provisions of the federal tax law may give rise to situations in which a beneficiary inadvertently turns a spendthrift trust into a self-settled trust. In particular, granting a beneficiary the power to withdraw a gift, in order to make the gift a qualifying "present interest" for federal gift tax exclusion, may have the consequence of making the assets of the trust part of the gross estate of the beneficiary for estate tax purposes. This result can be partially avoided, at least, if the power to withdraw is allowed to lapse. However, the power of withdrawal may also be construed as turning the trust into a self-settled trust under state law, making the assets available to creditors and making the assets part of the beneficiaries gross estate and subject to the gift and estate tax.

Small Estates.

Estates with limited assets consisting of personal property may qualify for an expedited procedure instead of probate. The successor in interest to the personal property of a deceased person may use an affidavit to gain possession of property from a third party in the case of a small estate. A typical example of such property would be a bank account of the deceased person. The successor in interest may give the bank an affidavit stating, among other things: that at least 40 days have passed since the death; that no appointment of a personal representative for the estate is pending; that all debts of the estate have been paid, and that the successor is entitled to the property. The maximum value of an estate to which this affidavit procedure applies is \$60,000, an amount that was last adjusted in 1993 when it was raised from \$30,000.

Recommendations of the Bar Association.

The Real Property, Probate and Trust Section of the Washington State Bar Association has proposed various updates and changes to the trust and estate laws.

Summary of Bill:

Numerous changes are made to the trust and estate laws. Many of the changes enable Washington trusts to take advantage of federal tax provisions, or protect Washington trusts against inadvertently missing or losing favorable federal tax treatment.

Washington Principal and Income Act of 2002.

The Principal and Income Act is expressly made applicable to trusts that are converted to unitrusts. The 4 percent payout for a unitrust is retained as the default amount, but if the trust instrument allows it, a trustee may select an annual payout of between 3 and 5 percent. A unitrust trustee is allowed to allocate, reasonably and impartially, certain capital gains as income in order to achieve favorable federal tax treatment.

Marital Deduction.

Unless a contrary intent is expressed, a gift is presumed to be intended to take advantage of any available state or federal tax exemption, exclusion, deduction or credit. For instance, a gift to a spouse is presumed to be intended to qualify for the marital deduction. These presumptions may be overcome only by clear, cogent, and convincing evidence.

The trust gift distribution law is amended to explicitly allow Washington trusts to achieve favorable estate tax treatment under the state law as well as the federal estate tax law. The gift distribution law is also clarified to expressly cover marital gifts whether they are lifetime, testamentary, outright or in trust.

The trust gift distribution law is also amended to be consistent with federal law with respect to allowable periods of required spousal survival beyond the death of a spouse making a gift that qualifies for the marital deduction.

Spendthrift Trusts.

The lapse of a beneficiary's power of withdrawal does not result in the property over which the power could have been exercised being considered as having been placed in the trust by the beneficiary. Therefore, such a lapse does not result in the unintended creation of a self-settled trust the assets of which would be subject to creditors' claims.

Small Estates.

The maximum value of a small estate that qualifies for disposition by affidavit instead of probate is raised from \$60,000 to \$100,000.

Miscellaneous Provisions.

Various technical changes are made to the Trust and Estate Dispute Resolution Act, the law relating to will contests, and the law relating to powers of appointment.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.