Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Judiciary Committee

SB 5057

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 Summary of Bill

- Amends the Washington Principal and Income Act of 2002 by changing provisions relating to income taxes paid by trustees on receipts from pass-through business entities.

Hearing Date: 3/14/11

Staff: Kelly Pfundheller (786-7289).

Background:

The Washington Principal and Income Act (WPIA) governs the allocation of receipts and disbursements of a trust. The WPIA contains procedures for trustees to allocate assets to principal and income, and to govern their proper distribution to beneficiaries, heirs and devisees. "Principal" means property held in trust for distribution to a remainder beneficiary. "Income" means money or property that a trustee receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange, or liquidation of a principal asset.

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 a pass-through business entity, such as a partnership or S corporation, it must report its share of the entity's taxable income regardless of how much the entity distributes to the trust. This is because pass-through entities elect to pass corporate income, losses, deductions and credit through their shareholders, making the shareholders responsible for the taxes owed on the entity. Even in cases where the entity retains some of the trust's share of taxable income, the trustee must pay the taxes on the entire share and deduct the amount paid between income and principal. Current law provides that the tax is paid from principal to the extent that the receipts from the entity are allocated to principal and the trust's share of the entity's taxable income exceeds the total receipts distributed to the trust.

Summary of Bill:

The bill establishes a method for determining whether a tax on the trust's share of a pass-through business entity's taxable income is charged to income or to principal. A tax required to be paid by a trustee must be charged:

- to income to the extent that receipts from the entity are allocated only to income;
- to principal to the extent that receipts from the entity are allocated only to principal;
- proportionately to income and principal to the extent that receipts from the entity are allocated to both income and principal; and
- otherwise to principal.

The trustee must adjust the 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.

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