# HOUSE BILL REPORT
# SSB 5171

**As Passed House - Amended:**
April 6, 2009

**Title**: An act relating to modifying the Washington principal and income act of 2002.

**Brief Description**: Modifying the Washington principal and income act of 2002.

**Sponsors**: Senate Committee on Judiciary (originally sponsored by Senators Kline and Rockefeller; by request of Uniform Legislation Commission).

**Brief History:**
**Committee Activity:**
Judiciary: 3/11/09, 3/16/09 [DPA].
**Floor Activity**
Passed House - Amended: 4/6/09, 94-2.

**Brief Summary of Substitute Bill**
**(As Amended by House)**

- Amends the Washington Principal and Income Act of 2002 by changing provisions related to estate tax marital deductions.

## HOUSE COMMITTEE ON JUDICIARY

**Majority Report**: Do pass as amended. Signed by 10 members: Representatives Pedersen, Chair; Goodman, Vice Chair; Rodne, Ranking Minority Member; Shea, Assistant Ranking Minority Member; Flannigan, Kelley, Kirby, Ormsby, Roberts and Warnick.

**Staff**: Courtney Barnes (786-7194)

**Background**:

The National Conference of Commissioners on Uniform State Laws (NCCUSL) is an organization that authors and promotes enactment of uniform state laws in areas of law where national uniformity is desirable and practical. The Washington Uniform Legislation Commission (Commission) was established to promote uniformity of legislation with other states. The Commission works with similar commissions from other states, including

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

NCCUSL, to draft and recommend uniform laws for approval and adoption by the various states.

Washington Principal and Income Act of 2002.

The current Principal and Income Act is based on a version of the Uniform Principal and Income Act and has rules about allocating the receipts and disbursements of a trust. 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 trustee is to act impartially among them and is to take into account the differing interests of the beneficiaries. The Principal and Income Act gives a trustee the power to reallocate or adjust receipts of the trust between or among beneficiaries.

Marital Deductions for Deferred Compensation, Annuities, and Similar Payments.

Federal law allows a marital deduction from the federal estate tax for property left for the benefit of a surviving spouse. When a marital trust is the named beneficiary of a decedent's individual retirement account (IRA) or other qualified retirement plan, the surviving spouse may be considered to have a qualifying income interest for life in the IRA and in the marital trust for purposes of an election to treat both the IRA and the trust as qualifying terminable interest property (QTIP). According to a recent ruling of the Internal Revenue Service (IRS), if the marital deduction is sought, the QTIP election must be made for both the IRA and the trust IRS Rev. Rul. 2006-26).

**Summary of Amended Bill**:

Marital Deductions for Deferred Compensation, Annuities, and Similar Payments.

The definition of "payment" is amended to include any payment from any separate fund, regardless of the reason for the payment. "Separate fund" is defined.

The provision authorizing a trustee to allocate more of a payment to income to qualify for an estate tax marital deduction is removed. In determining the allocation of a payment made from a separate fund, a trustee must determine the internal income of each separate fund as if the fund was a trust subject to the Principal and Income Act. This provision applies only when a trustee is determining the allocation of a payment made from a separate fund to: (1) a trust to which an election to qualify for a marital deduction is made under the IRS code governing life estates for surviving spouses; or (2) a trust that qualifies for the marital deduction under the IRS code governing life estates where the power of appointment resides in the surviving spouse.

The surviving spouse may request the trustee to demand that the person administering the separate fund distribute the internal income to the trust. A formula is provided for how payment from the separate fund is allocated to income or principal. If a trustee cannot determine the internal income of the separate fund, a formula is provided depending on whether the trustee can determine the value of the separate fund.

Survivor annuities are excluded from these provisions to the extent that the series of payments would qualify for the marital deduction under the IRS code governing survivor annuities.

A timeline is given for when the provisions related to deferred compensation, annuities, and similar payments apply, depending on when the trust is funded.

**Appropriation**: None.

**Fiscal Note**: Not requested.

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

**Staff Summary of Public Testimony**:

(In support) The bill corrects a problem created by a recent IRS ruling. The IRS rejected a rule that Washington and other states have adopted. The bill also addresses income taxes on receipts from business entities, which is an issue that has been litigated. The bill should be amended to correct some technical issues, including the formulas used by the trustee to make certain allocations to income and principal. The Commission supports this bill because Washington is out of sync with the IRS position on IRA distributions and marital estate tax deductions.

(Opposed) The bill amends provisions related to income taxes on receipts from business entities, which is a very complicated issue. The approach taken by the bill to address income tax allocations may not be the best option for Washington. The section of the bill amending the tax provisions in section two should be removed so the Washington State Bar Association (WSBA) can study this issue and involve other stakeholders, including profession fiduciaries, trustees, and certified public accountants. At the very least, the effective date should be delayed so the WSBA has time to educate those who will be affected by the changes made in section two.

**Persons Testifying**: (In support) Marlin Appelwick, Washington Uniform Legislation Commission.

(Opposed) Beth McCaw, Washington State Bar Association.

**Persons Signed In To Testify But Not Testifying**: None.