

SENATE BILL REPORT

SSB 5171

As Amended by House, 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: 1/23/09, 1/27/09 [DPS].

Passed Senate: 2/27/09, 45-0.

Passed House: 4/06/09, 94-2.

SENATE COMMITTEE ON JUDICIARY

Majority Report: That Substitute Senate Bill No. 5171 be substituted therefor, and the substitute bill do pass.

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

Staff: Kim Johnson (786-7472)

Background: The National Conference of Commissioners on Uniform State Laws (NCCUSL) is a non-profit association and drafts model uniform state laws on subjects where consistency from state to state is desirable. The Washington Uniform Legislation Commission (WULC) was created in 1905 and analyzes whether uniform laws recommended by NCCUSL and others are appropriate for incorporation into Washington laws.

Washington adopted the Uniform Principal and Income Act (UPIA) in 1971 and updated it in 2002. UPIA governs the allocation of income versus principal for the receipts and disbursements of a trust or estate. Trusts and estates have two classes of owners: those that have an interest in the entities income, and those that have an interest in the principal. The UPIA governs how a receipt or disbursement is to be categorized (principal or income) and will determine which equity interest holder is to receive the benefit of any receipt or whose interest will be reduced by a disbursement.

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.

The WULC, working with the NCCUSL, has recommended two amendments to the UPIA to address: (1) an ambiguity in a formula regarding tax distributions from flow-through entities to trusts; and (2) an Internal Revenue Service (IRS) ruling on distributions from retirement plans to marital trusts.

When a trust owns an interest in a pass-through entity, such as a partnership, it must report its share of the entity's taxable income regardless whether the trust actually receives all of the income. Whether the entity distributes more or less than the trust's tax on its share of the entity's taxable income, the trust must pay the taxes and allocate them between income and principal. Because the trust's taxes and amounts distributed to a beneficiary are interrelated, the trust may be required to apply a formula to determine the correct amount to pay to a beneficiary.

The IRS has issued Revenue Ruling 2006-26 which found that because of the way "income" was defined in the UPIA, retirement benefits left in trust do not qualify for its safe harbor for marital deductions, unless the estate plan was specifically drafted to address this issue.

Summary of Substitute Bill: The definition of "payment" is amended to include any payment from a separate fund in certain circumstances. "Separate fund" is also defined.

The requirement that a trustee allocate to income an amount necessary to obtain a marital deduction is repealed.

A trustee, in determining the allocation of a payment made from a separate fund, must determine the internal income of each separate fund for the accounting period as if the separate fund were a trust covered by the UPIA. This applies when a trustee is determining the allocation of a payment made from a separate fund: (1) to a trust to which an election to qualify for a marital deduction has been made under the IRS Code relating to life estates for surviving spouses; (2) to a trust that qualifies for the marital deduction under IRS Code relating to life estates with power of appointment; and, (3) if the series of payments qualify for the marital deduction under the IRS Code relating to survivor annuities.

A formula is provided in instances when the trustee cannot determine either the internal income or the fund's value.

The allocation of a tax required to be paid by a trustee based on the trust's share of an entity's taxable income is amended to include the following: taxes required to be paid by a trustee on the trust's share of an entity's taxable income must be paid proportionately from principal and income, to the extent that receipts from the entity are allocated to both income and principal; and taxes must be paid from principal, to the extent that the tax exceeds the total receipts from the entity.

A trustee must adjust income or principal receipts to the extent that the trust's taxes are reduced because the trust receives a deduction for payments made to a beneficiary.

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: The IRS took a look at the UPIA and took issue with some of the language used. This bill is our attempt to clean up two glitches in the language so that people who have set up their estate to avoid certain tax implications are not rudely surprised because the current state of our law does not match up with federal requirements. The IRS wouldn't say in advance whether the language we've proposed will completely address their concerns. Regarding the amendment that is necessary, I intended to include 3 percent in the bill. I recommend you make a decision to choose 3 percent because it is deemed a conservative number given you have to allocate that amount for taxes.

Persons Testifying: PRO: Judge Marlin Appelwick, Washington State Uniform Legislation Commission.

House Amendment(s): The percentage that a trustee uses to determine how much money to hold in the trust in order to have sufficient funds to pay taxes is changed from 3 percent to 4 percent. A trustee must calculate the 4 percent allocation made to income using the most recent statement of value preceding the beginning of the accounting period in cases where no part of a payment is characterized as interest, a dividend, or an equivalent.

Section 2 of the bill, which changed provisions related to income taxes on receipts from business entities, is removed.