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MULTISTATE INCOME/FRANCHISE TAX

California enacts legislation requiring income from ING trusts to be included in grantor's income and subject to tax

Tax Alert

Overview

On July 10, 2023, the California governor signed Senate Bill 131 (SB 131) into law. SB 131 made several changes to California's tax laws, including a new Personal Income Tax Law ("PITL") provision that, for taxable years beginning on or after January 1, 2023, requires the income of an incomplete gift nongrantor ("ING") trust to be included in the grantor's gross income and subject to California income tax, as if the trust were a grantor trust.

This Tax Alert summarizes this specific change made by SB 131 to California's PITL and provides some taxpayer considerations.

Background on ING trusts

In general, a transfer of assets to an ING trust is not a completed gift by the grantor. The ING trust is a separate taxpayer and pays federal tax on the income generated by the transferred assets. Prior to SB 131, an ING trust was treated as a nongrantor trust under California law and paid California tax on its California source income and on its other income (in whole or in part) if the trust had a resident fiduciary, a resident non-contingent beneficiary, or if a distribution in excess of distributable net income was made to a resident contingent beneficiary.

Change made by SB 131 to the treatment of ING trusts

For taxable years beginning on or after January 1, 2023, SB 131 adds new California Revenue and Taxation Code ("CRTC") section 17082. SB 131 provides that the income of an ING trust is required to be included in the grantor's gross income to the extent the income of the trust would be taken into account in computing the grantor's taxable income if the trust were treated as a grantor trust under CRTC section 17731, except as provided for below. Thus, a

California resident individual that is a grantor of an ING trust will pay tax on the ING trust's income earned after January 1, 2023.

As noted above, SB 131 provides an exception where the income of an ING trust will not be included in a grantor's income for a taxable year if all of the following apply:

(1) The fiduciary of the ING trust timely files an original California Fiduciary Income Tax Return and makes an irrevocable election to be taxed as a resident nongrantor trust in accordance with CRTC section 17742.

(2) The ING trust is a nongrantor trust pursuant to Chapter 9 of Part 10 of Division 2 of the CRTC.

(3) 90 percent or more of the beneficiaries are charitable organizations, as defined in Internal Revenue Code section 501(c)(3).

Considerations

Taxpayers should consult with their California tax advisors on this change made under SB 131 and the impact that this change may have on their California tax liabilities, including potential issues relating to the payment of sufficient estimated taxes to prevent the imposition of a penalty.

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