Date of Hearing: July 7, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Mike Gipson, Chair

SB 376 (Valladares) – As Introduced February 13, 2025

Majority vote. Tax levy. Fiscal committee.

SENATE VOTE: 38-0

SUBJECT: Incomplete gift nongrantor trusts: Personal Income Tax Law

SUMMARY: Amends the definition of an "incomplete gift nongrantor (ING) trust" to specifically exclude a trust, or portion of a trust, that qualifies as a charitable remainder trust (CRT), as specified. Specifically, **this bill**:

1) Provides that a trust, or portion of a trust, that qualifies as a CRT under Internal Revenue Code (IRC) Section 664 shall not be considered an ING trust for California state tax purposes, even if the CRT otherwise satisfies the two relevant conditions that define an ING trust under existing law.

2) Finds and declares the following for purposes of complying with Revenue and Taxation Code (R&TC) Section 41:

   a) The specific goal of the exclusion is to continue to support charity efforts; and,

   b) There is no available data to collect or report regarding this tax expenditure.

3) Takes immediate effect as a tax levy.

EXISTING LAW:

1) Conforms to federal law, which provides that "gross income" includes all income from whatever source derived unless expressly excluded. (Internal Revenue Code (IRC) Section 61 and R&TC Section 17071.) Gross income includes compensation for services, business income, gain from selling property, interest, rents, royalties, dividends, and pensions.

2) Provides various exclusions from gross income in determining tax liability under the Personal Income Tax (PIT) Law. (R&TC Section 17131 *et seq.*)

3) Conforms, with modifications, to federal law regarding the treatment of trusts, including IRC Section 664, regarding the treatment of CRTs. (R&TC Section 17731.)

FISCAL EFFECT: The Franchise Tax Board (FTB) does not estimate any fiscal impacts from this bill as it is unnecessary and duplicative of existing law.

COMMENTS:

1) The author has provided the following statement in support of this bill:

   SB 376 aims to clarify a conflict between a California income tax statute and a corresponding federal provision that California has adopted. While the Franchise Tax Board, FTB, has provided guidance on the issue, the California statute itself has not directly addressed it. Specifically, Revenue and Tax code Section 17082, enacted in July 2023, governs the taxation of income from incomplete gift nongrantor trusts or INGs. However, the working of this could be interpreted to also apply to charitable remainder trusts or CRTs that qualify as INGs, potentially subjecting their income to California tax. CRTs, however, are subject to a special taxation regime described in California Revenue and Taxation Code section 17731. SB 376 would formally confirm what the FTB has consistently stated – that CRTs are not subject to Section 17082. By codifying this interpretation, the bill would eliminate any ambiguity or conflict between Sections 17082 and 17731.

2) Writing in support of this bill, California Lawyers Association, Trusts and Estates Section and Taxation Section notes, in part:

   SB 376 would codify what the FTB has stated, thereby removing in the California statute itself any conflict between Revenue and Taxation Code section 17082 and Internal Revenue Code section 664, as adopted in California by Revenue and Taxation Code section 17731. Specifically, the bill would amend Revenue and Taxation Code section 17082 to explicitly provide that the definition of ING does not include a trust, or portion of a trust, that qualifies as a CRT.

3) Committee Staff Comments:

   a) *Trusts, in general*: Federal law establishes two general types of trusts – grantor trusts and non-grantor trusts. Grantor trusts are revocable and the grantor retains control over the trust. These trusts are not taxed as separate entities. All of the items of income, deduction and credit flow through to the personal return of the grantor.

      Non-grantor trusts are irrevocable, which generally means that the grantor does not retain control over the trust. These trusts are treated differently. They are taxed on their accumulated income as if they were separate entities. When the trust makes a distribution to a beneficiary, the trust is allowed a distribution deduction, and the trust passes the income along to a beneficiary. The distribution from the non-grantor trust to its beneficiaries is subject to tax. The beneficiary reports the income and pays the tax.

   b) *ING trusts*: An ING trust is a type of non-grantor trust where the grantor establishes the trust for the benefit of the grantor and other discretionary beneficiaries. The grantor's transfer of assets to the ING trust is treated as an incomplete gift under IRC section 2511 and the regulations thereunder. Because the grantor's gift to the trust is incomplete, the grantor may fund the trust without using the lifetime estate tax exemption or incurring a federal gift tax liability. The trust is considered irrevocable.

      Within the ING trust structure, the trust maintains control over the assets and any distributions are controlled by the trust distribution committee. This distribution committee approves the distributions that the grantor receives. The result is that the grantor retains sufficient control over the assets to be treated as not having made a completed gift of the assets, while at the same time being treated as having retained insufficient control over the assets to be considered the owner of the assets for income tax purposes.

There are many private letter rulings that conclude that ING trusts are not grantor trusts for federal income tax purposes under IRC sections 671 through 679. As a result, ING trusts are generally treated as taxable trusts rather than disregarded taxable entities. This means that the net taxable income of the ING trust is subject to federal income tax.

c) *A popular tax avoidance strategy*: Some members of the estate planning and wealth management industry were not shy in advertising ING trusts as an aggressive but valuable strategy for high-income taxpayers who want to reduce their state-level tax burdens. By establishing an ING trust in a state with no income tax, a resident of a state with an income tax could grow their assets tax-free while still retaining some control over them. For example, a document readily available online describes ING trusts as follows:

> The ING design often allows the trust to escape state income tax in the settlor's state of residency. The savings can be tremendous, depending on the state and amount avoided – up to 13.3%. Thus, INGs are trusts that have all of the asset protection characteristics of a typical domestic asset protection trust (DAPT), but with the added benefit of being able to avoid state income tax in many situations, and as discussed below, may have federal income tax benefits as well, primarily when the taxpayer and their family are charitably minded or desire to the shift income tax burden to beneficiaries who are in lower income tax brackets. Non-grantor trust taxation enables much more advantageous deductions in those areas.[1]

d) *States catch on*: New York was the first state to amend its personal income tax laws to address the growing trend of ING trusts being used to avoid state-level taxation. New York resident grantors were effectively moving assets and taxable income outside of the New York state taxing jurisdiction by creating an ING trust with a nonresident trustee in states such as Delaware, Wyoming, Nevada, South Dakota, etc., which are states with no personal income tax. Thus, the taxable income from these New York resident grantor ING trusts was not being taxed by New York. For taxable years beginning on or after January 1, 2014, New York enacted legislation eliminating the ING trust problem by taxing this income. New York added the net income of an ING trust to the adjusted gross income of the New York resident individual as if the trust was a grantor trust.

California followed New York's lead by amending its personal income tax laws to require that the net income derived from an ING trust's assets be included in the grantor's gross income and subject to California income tax by enacting SB 131 (Committee on Budget and Fiscal Review), Chapter 55, Statutes of 2023.

For taxable years beginning on or after January 1, 2023, the income from an ING trust is

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[1] Morrow, *Incomplete Gift, Non Grantor Trusts (aka DINGs, NINGs): Not* Just *for State Income Tax Avoidance*, Ultimate Estate Planner (May 2016). https://ultimateestateplanner.com/wp-content/uploads/2016/05/May2016-DINGsBasic.pdf.

included in a qualified taxpayer's gross income to the extent the income would have been taken into account in computing the qualified taxpayer's taxable income as if the trust, in its entirety, were treated as a grantor trust under Section 17731.

The ING trust income is excluded from the qualified taxpayer's gross income for a taxable year if all of the following apply:

i) The ING trust's fiduciary timely files an original California Fiduciary Income Tax Return and makes an irrevocable election, in the form and manner prescribed by the FTB, on that return to be taxed as a resident nongrantor trust;

ii) The ING trust is a nongrantor trust; and,

iii) 90% or more of the ING trust's distributable net income is distributed, or treated as being distributed, to a charitable organization as defined in IRC Section 501(c)(3).

e) *Charitable trusts*: Unlike ING trusts, which are not explicitly contemplated in federal law and are the result of carefully structured planning, federal law explicitly establishes CRTs and their requirements. CRTs are irrevocable trusts that qualify under IRC Section 664 for favorable tax treatment and are administered in two phases. During the initial phase, a CRT makes periodic payments to the grantor or other designated beneficiaries, based either on a fixed annuity amount or a percentage of the trust's assets as updated annually. Once the initial phase is done, which either occurs after a fixed term of years or at the death of the beneficiaries, all remaining assets pass to charity and the CRT terminates.

There are two major tax benefits for CRTs. First, upon funding a CRT, the grantor receives a charitable deduction based on the actuarial value of the remainder interest earmarked for charity. Second, a CRT does not pay income tax. Instead, the distributions to non-charitable beneficiaries carry out income tax in accordance with a tiered system. As a result, any income tax generated by the CRT assets is deferred until distributions are made to the non-charitable beneficiaries.

California conforms to IRC Section 664 with the modification that the $10,000 minimum benefit specified in IRC Section 692(d)(2) does not apply.

f) *Clarifications made so far*: According to the sponsor, the enactment of R&TC Section 17082 prompted questions from practitioners in the estate planning and wealth management industry because ING trusts and CRTs share some similarities. The FTB has addressed this question multiple times on various webpages:

i) "Section 17082 does not apply to Charitable Remainder Trusts (CRT). California conforms to [Internal Revenue Code] section 664, and its underlying regulations. Accordingly, the income from CRTs is not subject to this new provision";[2]

ii) "Charitable remainder trusts (CRT) are not subject to Section 17082"; and,[3]

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[2] *Tax News*, FTB (October 2023). https://www.ftb.ca.gov/about-ftb/newsroom/tax-news/october-2023/index.html#article4.

iii) On a Question and Answer page concerning INGs and Section 17082: "Q13: Are CRTs impacted by this provision? A13: No, CRTs are governed under IRC section 664."[4]

g) *What is a "tax expenditure"*? Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone revenues).

As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are typically reviewed less frequently than direct expenditures. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote.

h) *Committee's tax expenditure policy*: Both R&TC Section 41 and Committee policy require any tax expenditure bill to outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. A tax expenditure bill will not be eligible for a Committee vote unless it has complied with these requirements.

In its current form, this bill states that the gross income exclusion is designed to continue to support charity efforts. In addition, this bill provides that there is no available data to collect or report to measure the exclusion's effectiveness.

In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. According to this policy, an "appropriate sunset provision" means five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" means ten years. This bill, as currently drafted, does not comply with the Committee's policy on sunset dates.

i) *Is this a tax expenditure?* According to the author and sponsor, this bill is simply seeking to codify the FTB's public guidance regarding the applicability of the ING trust statute to CRTs. SB 376 is not intended to create a new tax expenditure that would result in taxpayers reducing their taxable income; rather, this bill is intended to merely clarify existing law to address a potential conflict with other areas of state tax law that specifically address CRTs. Accordingly, the author has agreed to the technical

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[3] *Incomplete Gift Non-Grantor (ING) Trusts*, FTB. https://www.ftb.ca.gov/file/personal/filing-situations/estates-and-trusts/incomplete-nongrantor-trusts.html.
[4] *Help with incomplete nongrantor (ING) trusts*, FTB. https://www.ftb.ca.gov/file/personal/filing-situations/estates-and-trusts/help-with-ing-trusts.html

amendments described below. With these amendments, this bill would be not be subject to this Committee's policies regarding tax expenditures and would not require a 5-year sunset or Section 41 language.

j) *Suggested amendments*:

  i) Replace the findings and declarations relating to Section 41 with the following:

  > The Legislature finds and declares that the amendments made to Section 17082 of the Revenue and Taxation Code by Section 2 of this act do not constitute a change in, but are declaratory of, existing law.

  ii) On Page 3, Line 12: delete "Notwithstanding subparagraph (A)"; and,

  iii) Delete the language providing that this bill is a tax levy and shall go into immediate effect.

REGISTERED SUPPORT / OPPOSITION:

Support

California Lawyers Association, Trusts and Estates Section and Taxation Section

Opposition

None on file

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