Department of Finance and Administration

Legislative Impact Statement

Bill: HB1830
Bill Subtitle: TO AMEND THE INCOME TAX LAWS RELATING TO CERTAIN TRUSTS; TO PRESERVE CERTAIN TRUST ASSETS; AND TO EXEMPT CERTAIN TRUSTS FROM INCOME TAX.

Basic Change :

Sponsor: Rep. Hodges

HB1830 allows an exemption from the income tax imposed under § 26-51-101, et seq for a trust that is administered by a trustee who is a resident of Arkansas if the trust is not considered a grantor trust under 26 U.S.C. § 671 as it existed on January 1, 2019, and any related regulations, as they existed on January 1, 2019. The effective date is for tax years beginning on or after January 1, 2019.

Revenue Impact :

FY 2020 - $16.2 Million Reduction in State General Revenue

[Revenue Impact is gathered from actual tax reported on 2017 AR Fiduciary Income Tax Returns. The above estimate does not include the tax paid on the income passed out via K-1s and paid at the individual level.]

Taxpayer Impact :

Arkansas resident taxpayers with non-grantor trusts will be exempt from income tax.

Resources Required :

Computer programs, tax forms and instructions will need to be updated.

Time Required :

Adequate time is provided for implementation.

Procedural Changes :

Computer programs, tax forms and instructions as well as training manuals will need to be updated. Department employees will need to be educated as well as the tax community.

Other Comments :

None.

Legal Analysis :

Under the Income Tax Act of 1929, tax is levied upon the entire income of every resident, individual, trust, or estate. With regard to trusts, a trustee is liable for tax on the net income of a trust that has neither been distributed nor become distributable to a beneficiary during the tax year. A trustee is a person or entity who holds legal title to property in trust and as a fiduciary for the benefit of another

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natural person or company. Generally, the trustee is liable for tax on income retained in trust, and the beneficiary is liable for tax on income that the trustee distributes or that is distributable to the beneficiary. A trust is treated as a separate entity and taxed as a corporation during a tax period in which it has been created or used to carry on a business and has corporate characteristics such as centralized management, continuity of existence, and limited liability. In such a case, the trustee would be liable for the tax.

However, a type of trust called a "grantor trust" can be an exception to this rule. The person or company who creates any type of trust is called the trust's "grantor". A grantor trust is a trust in which the grantor retains control over the trust assets to such an extent that the grantor is treated as the owner of the trust assets for income tax purposes. This may be true even when the grantor is not the trustee and does not hold legal title. In determining whether a trust is a grantor trust, the grantor's degree of control over the trust property must be analyzed. The Arkansas Department of Finance and Administration (DFA) by rule uses I.R.C. § 671 *et seq.* to make this determination. When the grantor of a trust does not retain control over the trust property to such an extent that the grantor is to be treated as the owner of the trust, the trust is a "nongrantor trust."

HB1830 would exempt from tax all income owned by a resident trustee of a nongrantor trust. Such exempted income could derive from dividends, interest, rents, royalties, capital gains, ordinary gains, business income, compensation from the performance of contracts, annuities, securities, or any other accession to wealth. HB1830 would allow a person or entity to gift income-producing property of any kind to the trustee of a nongrantor trust, and neither the trustee nor the grantor would be liable for the tax that otherwise would have applied had the recipient of the income not been a resident trustee of a grantor trust. Nothing in HB1830 would prevent the trustee of a nongrantor trust from gifting trust property. Generally, property received as a gift is exempt from income tax unless the property is derived from an investment or sale of property. HB1830 is not clear whether trust income that the trustee subsequently gifts would be subject to tax. Regardless, nothing in HB1830 would prevent a trustee or successor trustee from indefinitely holding income received and preventing that income from being subject to tax.

The act would be effective beginning with the 2019 tax year.