

# Department of Finance and Administration

## Legislative Impact Statement

**Bill: HB1911**

**As Engrossed: 4/5/2019**

**Bill Subtitle: TO AMEND THE INCOME TAX ACT OF 1929 CONCERNING WHO SHALL BE TREATED AS THE OWNER OF A PORTION OF A TRUST.**

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### Basic Change :

**Sponsor: Rep. M. Gray**

**Engrossed 04/05/19 --- Senate Amendment 1** --- The amendment adopts 26 U.S.C §§ 671-679 as in effect on January 1, 2019, for the 2020 and following tax years. Section 1 of the previous version of the bill pertaining to the legislative intent of this bill is retained. Section 1 provides that it is the intent of the General Assembly to:

- Adopt 26 U.S.C. §§ 671-679, as they existed on January 1, 2019, in recognition of the fact that the Income Tax Act of 1929, § 26-51-101 et seq., has not previously addressed the issue of the taxation of trusts and their beneficiaries that are grantor trusts for federal income tax purposes;
- For the purposes of Arkansas income taxes, conform the income tax treatment of trusts and beneficiaries that are grantor trusts for federal income tax purposes; and
- Provide for prospective application of the adoption of 26 U.S.C. §§ 671-679, as they existed on January 1, 2019, to provide Arkansas taxpayers adequate time to arrange their financial and tax affairs.

The amendment removes Section 3 of the previous version of the bill, which would have directed the Director of the Department of Finance and Administration to repeal Comprehensive Individual Income Tax Rule 4.26-51-102, by reason that the DFA Director "did not have the authority to adopt 26 U.S.C. §§ 671-679 and the related federal regulations and [Rule 4.26-51-102] is inconsistent with 26 U.S.C. §§ 671-679 and the related federal regulations."

**Engrossed 04/03/19 --- House Amendment 1** --- The amendment adopts 26 U.S.C §§ 671-679 as in effect on January 1, 2019. HB1911, as originally introduced, adopted 26 U.S.C §§ 671-679 as in effect on January 1, 2018. The bill also changes the effective date of the bill to provide that the adoption of the federal code sections would be effective for the 2020 and following tax years. As originally introduced, the bill would have been effective for the 2019 and following tax years.

The amendment also adds the following two sections that are not to be codified:

- The first additional section provides a statement of legislative intent to provide that 26 U.S.C. §§ 671-679, as in effect on January 1, 2019, be adopted prospectively. In addition, this additional section states that the General Assembly recognizes that the Income Tax Act of 1929, § 26-51-101, et seq, has not previously addressed the issue of taxation of trusts and their beneficiaries that are grantor trusts for federal income tax purposes.
- The second additional section provides that the Director of the Department of Finance and Administration (DFA) shall repeal Comprehensive Individual Income Tax Rule 4.26-51-102. This section states that the Director did not have authority to adopt 26 U.S.C. §§ 671-679 and the related federal regulations and the "Comprehensive Individual Income Tax Regulation 4.26-51-102 is inconsistent with 26 U.S.C. §§ 671-679 and the related federal regulations."

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**Original Bill** --- HB1911 amends § 26-51-201 by adopting federal law, 26 U.S.C. §§ 671-679 as in effect on January 1, 2018. The federal income tax laws are adopted for purposes of determining whether the grantor or another person shall be treated as the owner of a portion of a trust. These changes will clarify that Arkansas taxpayers will have the same rules for both federal and state income tax purposes.

### **Revenue Impact :**

None.

### **Taxpayer Impact :**

26 U.S.C. §§ 671-679, as in effect on January 1, 2019, will be adopted prospectively for the 2020 and following tax years for income tax purposes.

### **Resources Required :**

None.

### **Time Required :**

Adequate time is provided for implementation.

### **Procedural Changes :**

None.

### **Other Comments :**

None.

### **Legal Analysis :**

Arkansas law provides for an income tax on the entire income of every resident, individual, trust, or estate. Gross income includes gains or profits and income derived from any source whatever. In 1997, the Arkansas Department of Finance and Administration (DFA) promulgated Rule 4.26-51-102 of its Comprehensive Individual Income Tax Regulations to determine who should be deemed the owner of a trust or a portion of a trust, and thus responsible for the gains realized by the trust's property. Rule 4.26-51-102 uses the same analysis as Internal Revenue Code § 671 et seq.

When property is owned subject to a trust agreement, questions arise with regard to who is liable for the taxes that derive from the trust property. Internal Revenue Code § 671 et seq. addresses the specific question of under what circumstances is the creator (or grantor) of the trust, instead of the trustee of the trust, liable for the taxes that derive from the trust property. The general factor to be considered in the analysis is the degree of control that the grantor retains over the trust property. An

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example can be found at I.R.C. § 674: "The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the [trust property] is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party." For purposes of the rule, "adverse party" means "any person having a substantial beneficial interest in the trust that would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust."

HB1911 would expressly adopt in the Arkansas Code Internal Revenue Code §§ 671-679 as they existed on January 1, 2019 and would apply those statutes for tax years beginning on or after January 1, 2020. DFA's Rule 4.26-51-102 will remain in effect.