Office of Senate Floor Analyses
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UNFINISHED BUSINESS

Bill No: SB 376
Author: Valladares (R)
Amended: 7/15/25
Vote: 21

SENATE REVENUE AND TAXATION COMMITTEE: 5-0, 5/14/25
AYES: McNerney, Valladares, Ashby, Grayson, Umberg

SENATE APPROPRIATIONS COMMITTEE: Senate Rule 28.8

SENATE FLOOR: 38-0, 6/2/25
AYES: Allen, Alvarado-Gil, Archuleta, Arreguín, Ashby, Becker, Blakespear, Cabaldon, Caballero, Cervantes, Choi, Cortese, Dahle, Durazo, Gonzalez, Grayson, Grove, Jones, Laird, Limón, McGuire, McNerney, Menjivar, Niello, Ochoa Bogh, Padilla, Pérez, Richardson, Rubio, Seyarto, Smallwood-Cuevas, Stern, Strickland, Umberg, Valladares, Wahab, Weber Pierson, Wiener
NO VOTE RECORDED: Hurtado, Reyes

ASSEMBLY FLOOR: 66-0, 9/10/25 – Roll call not available

SUBJECT: Incomplete gift nongrantor trusts: Personal Income Tax Law

SOURCE: California Lawyers Association, Trusts and Estates and Taxation Sections

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DIGEST: This bill amends the income exclusion requirement that applies to Incomplete Gift Nongrantor Trusts (INGs) to provide that the definition of an ING does not include a trust, or portion of a trust, that qualifies as a Charitable Remainder Trust.

Assembly Amendments (1) delete the measure's legislative findings and declarations to comply with Section 41 of the Revenue & Taxation Code; (2) remove its provision stating that the measure take effect immediately as a tax levy; and (3) add a legislative finding and declaration that its provisions do not constitute a change in, but instead are declaratory of, existing law.

ANALYSIS:

Existing law:

1) Provides that gross income includes all income from any source, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, including distributions of income or principal from a trust, unless specifically excluded.

2) Generally conforms with federal law regarding trusts, but provides that California can only tax trusts where:

   a) The trustee is a California resident;

   b) The trust has a noncontingent beneficiary who is a California resident;

   c) The trust has income from a California source; or

   d) The trust distributes income to a California resident beneficiary.

3) Conforms to federal law regarding Charitable Remainder Trusts (CRTs), where grantors transfer assets, of which at least 10% of the assets are distributed to a charity after a specified period or the death of the trust's beneficiaries.

4) Requires California residents to add the net income of an Incomplete Gift Nongrantor (ING) trust to their adjusted gross income for Personal Income Tax purposes, with some exceptions (SB 131, Committee on Budget & Fiscal Review, Chapter 55, Statutes of 2023).

5) Defines "Incomplete Gift Nongrantor Trust" as a trust that meets both of the following requirements:

   a) Does not qualify as a grantor trust under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Internal Revenue Code (IRC), relating to grantors and others treated as substantial owners.

   b) The qualified taxpayer's transfer of assets to the trust is treated as an incomplete gift under Section 2511 of the IRC, relating to transfers in general.

6) Exempts from the income inclusion requirement an ING trust that:

   a) Its fiduciary timely files an original California Fiduciary Income Tax Return and makes an irrevocable election, in the form and manner prescribed by the

Franchise Tax Board (FTB), on that return to be taxed as a resident nongrantor trust.

b) The ING trust is a nongrantor trust.

c) 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).

This bill:

1) Amends the definition of Incomplete Gift Nongrantor Trusts used in its income inclusion requirement to provide that it does not include a trust, or portion of a trust, that qualifies as a charitable remainder trust under IRC Section 664.

2) Makes a conforming change.

3) States that its changes do not constitute a change in, but are declaratory of existing law.

Background

Often used to transfer property from one generation to the next, trusts are specific legal agreements to hold and administer property, typically in a written document, where a trustee manages property on behalf of others. Trusts allow grantors to pass assets down to future generations while avoiding lengthy and costly probate proceedings. Trusts must identify:

- The creator of the trust, known as the trustor or grantor.
- The manager of the trust, known as a trustee or fiduciary.
- The person who will receive property from the trust, known as the beneficiary.
- The property the trust manages.

Trusts can have significant tax benefits for taxpayers who create them, and the beneficiaries who receive property and income. Some types of trusts can also enable the grantor to direct the transfer of property upon their death while retaining power over its assets, or the income they generate (dividends, capital gains, interest, royalties, etc.) while they are still alive.

California law mostly conforms with federal law regarding trusts, which divides trusts into two different types:

- Grantor trusts, which are revocable, so the grantor retains control over the trust. As a result, grantor trusts are not considered separate entities, so grantors report all income, deductions, and credits from grantor trusts on their personal income tax returns. Distributions to beneficiaries are not subject to tax because the trust is essentially disregarded as a taxable entity.

- Nongrantor trusts, which are irrevocable, so the grantor does not retain enough control over the trust. As a result, the trust is a separate entity which is taxed on its income. When the trust makes a distribution to a beneficiary, the trust deducts the distribution, which the beneficiary generally includes as taxable income.

INGs are also a type of nongrantor 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, so the transfer avoids federal gift taxes. While considered irrevocable, the trust maintains control over the assets and any distributions are controlled by a trust distribution committee, which approves any distributions to the grantor. The product of savvy tax professionals and some Internal Revenue Service Private Letter Rulings, INGs allow grantors to split a difference: They can have insufficient control to be considered a nongrantor trust, so as to move any accumulated income off of the grantor's federal tax return, while retaining enough control to not be considered a taxable gift.

While ING income is taxable for federal purposes, it can enable significant state tax avoidance. For example, residents of high tax states such as California can transfer appreciated assets (stock, other interests in businesses, or financial assets) to an ING created in a state without an income tax (usually Nevada or Delaware), where a trustee in that state manages the trust. Assets may continue to appreciate in value and generate income for the trust, with neither the gain nor the income subject to tax in the grantor's state of residence. Unless the out-of-state ING derives income from California, it has no obligation to file a return and report its income. The resident grantor can then move out of California to a state without an income tax, direct the ING to sell the assets, receive the distribution from the sale, and avoid state taxes entirely.

In 2014, the State of 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. In 2023, California enacted a similar requirement in SB 131.

However, SB 131's definition of ING could be construed as applying to some CRTs, or portions of them. CRTs must be nongrantor trusts under the specific section of the IRC that authorizes them, so that they satisfy the first part of the definition. Additionally, periodic payments made by the CRT to its grantor could be considered an incomplete gift, satisfying the second part. Lastly, living CRT grantors can choose which charities will receive the trust assets on trust termination, which can also be considered an incomplete gift.

FISCAL EFFECT: Appropriation: No Fiscal Com.: No Local: No

SUPPORT: (Verified 9/9/25)

California Lawyers Association, Trusts and Estates and Taxation Sections (Source)

OPPOSITION: (Verified 9/9/25)

None received

ARGUMENTS IN SUPPORT: According to the author, "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."

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