taxnotes® state

Volume 121, Number 2 ■ July 13, 2026

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Reprinted from *Tax Notes State*, July 13, 2026, p. 87

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In this article, Reefe and Nenno examine California's income tax and offer ways to mitigate expenses through the use of trusts.

California clients often ask whether there is any way to eliminate, reduce, or at least defer that exorbitant California income tax. The answer is yes, in many situations, through the proper use of trusts. And the potential savings are not insignificant. For example, via a properly constructed non-grantor trust, over $100,000 of California tax can be saved on a $1 million long-term capital gain! This article summarizes the rules and offers planning ideas.

Incidents of Taxation

California's framework for taxing the income of trusts is similar to those of the 41 other states that tax trust income and the District of Columbia (the "other taxing states") in some respects, but quite different in others.

Let's start with the similarities. First, as is the case in the other taxing states, an individual who qualifies as a resident for California income tax purposes and who is taxed on trust income under the federal grantor trust rules is usually also taxed on that income under California's version of those rules.[1] Second, as is also true in the other taxing states, the trustee of a trust that generates California-source income (that is, income attributable to California real property, tangible personal property, or business activity) must pay California income tax on that income.[2]

Now for the differences. First, in about two-thirds of the other taxing states, a trust is classified as a "resident trust" if the testator or trustor lived in the state, and the trustee must pay the state's income tax on all trust income. In California, however, a statute says taxability is determined "regardless of the residence of the settlor."[3] Rather, under California's sui generis system, the trustee of a non-grantor trust is taxed on income other than California-source income using two

[1] Cal. Rev. & Tax. Code section 17731(a). *But see* Cal. Rev. & Tax. Code section 17024.5(b)(6).

[2] *Steuer v. Franchise Tax Board*, 265 Cal. Rptr. 3d 216, 225 (Cal. Ct. App. 2020). *See* Cal. Code Regs. tit. 18, sections 17743-17744. *See also* Eric J. Coffill and Alexandra M. Louderback, "Sourcing Problems and Pitfalls Involving the California Taxation of Trusts," 30 *J. Multistate Tax'n & Incentives* 8 (June 2020). For the degree of deference that California courts must give to positions of the California Franchise Tax Board, see *Yamaha Corp. of America v. State Board of Equalization*, 960 P.2d 1031 (Cal. 1998); *In the Matter of the Appeal of Save Mart Supermarkets and Subsidiary*, 2002 WL 245682, at *3 (Cal. BOE Feb. 6, 2002). That level of deference probably has not changed following the U.S. Supreme Court's decision in *Loper Bright Enterprises Inc.v. Raimondo*, 603 U.S. 369 (2024). *See* Naftali Z. Dembitzer et al., "The States' Evolving Approaches to Deference After *Loper Bright*," *Tax Notes State*, Dec. 8, 2025, p. 703; Hugh Wesley Goodwin et al., "*Loper Bright* and SALT Administrative Rulemaking," *Tax Notes State*, Oct. 7, 2024, p. 7.

[3] Cal. Rev. & Tax. Code section 17742(a). A "settlor" generally is understood to be someone who sets up an *inter vivos* trust (*see* "Settlor," *Black's Law Dictionary* (2019)). Although the California Revenue and Taxation Code does not define settlor to encompass testators who establish trusts by their wills (*see* Cal. Rev. & Tax. Code sections 17003-17038), Form 541, "California Fiduciary Income Tax Return" (the "tax return instructions"), concede that "the taxability of non-California source income retained by a trust and allocated to principal depends on the residence of the fiduciaries and noncontingent beneficiaries, *not the person who established the trust*" (tax return instructions at 15-16; emphasis added).

criteria — the residences of the fiduciaries and the residences of the noncontingent beneficiaries:

> The income of [a] trust is taxable to the . . . trust. The tax applies to the . . . entire taxable income of a trust, if the fiduciary or beneficiary (other than a beneficiary whose interest in such trust is contingent) is a resident.[4]

The 2025 instructions for Form 541, "California Fiduciary Income Tax Return" (the "tax return instructions"), elaborate:

> Income retained by a trust is taxable to the trust. Income from California sources is taxable regardless of the residence of the fiduciaries and beneficiaries. R&TC Sections 17742 through 17745 provide that the taxability of non-California source income retained by a trust and allocated to principal depends on the residence of the fiduciaries and noncontingent beneficiaries, not the person who established the trust. Contingent beneficiaries are not relevant in determining the taxability of a trust.[5]

Second, many of the other taxing states classify an individual as a resident using two criteria — one subjective, one objective. Typically, the subjective factor is whether the individual is domiciled in the state, whereas the objective factor is whether they have a place of abode and spend more than a certain number of days (often 183) in the state during the tax year.[6] For California income tax purposes, in contrast, an individual is a resident if they are in the state for other than a temporary or transitory purpose or if they are domiciled in the state during the tax year.[7] An individual who spends more than nine months in the state during the tax year is presumed to be a resident.[8]

Third, California taxes a California resident beneficiary on income (ordinary as well as capital gains) distributed to the beneficiary on which the trustee had not already paid tax, either because a nonresident trustee was unaware of the tax obligation or believed that taxation was invalid or because the beneficiary's interest had previously been contingent.[9]

All of this is explored below.

The Resident Fiduciary Test

The residence of *any fiduciary* — not only a trustee — in California will subject a trust to California income tax.[10] The U.S. Supreme Court confirmed in *Kaestner*,[11] relying on its decision in *Greenough*,[12] that a state may tax a resident trustee of an otherwise nonresident trust without violating the due process clause. In addition, in *Steuer*,[13] the California Court of Appeal, First District, confirmed that "the Revenue and Taxation Code imposes taxes on the entire amount of trust income derived from California sources, regardless of the residency of the trust's

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[4] Cal. Rev. & Tax. Code section 17742(a). *See* Cal. Rev. & Tax. Code sections 17743-17744. *See also* Cal. Code Regs. tit. 18, sections 17743-17744. Effective January 1, 1963, the pertinent statute was amended to add "other than a beneficiary whose interest in such trust is contingent" (Cal. Rev. & Tax. Code section 17742, as amended by 1963 Cal. Stat. 1142), and another statute stipulates that the amendment was effective for post-1962 tax years only (Cal. Rev. & Tax. Code section 17745.1). As covered elsewhere, though, the constitutionality of the pre-1963 statute was questionable then and certainly is questionable now.

[5] Tax return instructions at 15-16.

[6] *See, e.g.*, N.Y. Tax Law section 605(b)(1).

[7] Cal. Rev. & Tax. Code section 17014(a). *See* Cal. Code Regs. tit. 18, section 17014. In *Opinion No. 23-701*, 2025 WL 2262382, at *1 (Cal. A.G. July 31, 2025), the California Office of the Attorney General confirmed that "when adjudicating a taxpayer appeal, the Office of Tax Appeals has the authority to issue a written opinion in which it concludes that applying a particular tax regulation to that taxpayer's circumstances would conflict with governing statutes [but not with provisions of the federal or California constitutions] and to decline to apply the regulation to the taxpayer on that basis. In making this determination, the Office must afford appropriate deference to the agency that promulgated the regulation."

[8] Cal. Rev. & Tax. Code section 17016. *See* Cal. Code Regs. tit. 18, section 17016; FTB Publication 1031, "2024 Guidelines for Determining Resident Status" (2024). *See also* Timothy P. Noonan and Emma M. Savino, "The Nuts and Bolts of California's Residency Rules," *Tax Notes State*, Apr. 6, 2026, p. 15.

[9] *See* Cal. Rev. & Tax. Code section 17745.

[10] Cal. Rev. & Tax. Code section 17742(a).

[11] *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 FamilyTrust*, 588 U.S. 262, 270 (2019).

[12] *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947).

[13] *Steuer*, 265 Cal. Rptr. 3d 216.

fiduciaries."[14] A fiduciary is a "trustee . . . or any person, whether individual or corporate, acting in any fiduciary capacity for any person . . . or trust."[15] That might include an adviser, protector, or any other person, as well as a trustee serving in a fiduciary capacity.[16]

As noted previously, rules are provided for determining whether an individual (presumably including an individual fiduciary) is a resident.[17] The place of residence of a corporate fiduciary is "the place where the corporation transacts the major portion of its administration of the trust."[18] A commentator explained in 2023:

> For [California] corporate fiduciaries, the non-California-source income is sourced to the location where the major portion of the trust administration occurs. Trust administration duties include paying the trust's bills, maintaining insurance for trust property, developing an investment strategy that balances cash flow with potential for asset growth with minimal or reasonable risk, overseeing the investments, maintaining detailed records, reporting promptly to beneficiaries, and making timely distributions to beneficiaries.[19]

For a trust that has multiple trustees, "the income taxable under Section 17742 shall be apportioned according to the number of fiduciaries resident in this state pursuant to rules and regulations prescribed by the Franchise Tax Board."[20] That guidance was issued and contains examples.[21] Accordingly, even if a testator or trustor wants to appoint a California fiduciary, California tax on nonsource income may be diminished if one or more non-California fiduciaries are included as well.

If the California resident trustee of a non-grantor trust is succeeded by a nonresident trustee during a tax year, the trust is taxed as a resident trust for the portion of the year during which it has a resident trustee, and as a nonresident trust for the rest of the year. On this issue, the tax return instructions[22] direct trustees to California FTB Publication 1100, which provides in pertinent part under the heading "Part-Year Resident":

> If you changed your residency, compute income and deductions using resident rules for the period of the year you were a California resident and nonresident rules for the period of the year you were a nonresident.[23]

The Resident Noncontingent Beneficiary Test

California taxes trusts with California noncontingent beneficiaries.[24] However, the state's interpretation of "contingent" opens the door to proactive planning opportunities to minimize

[14] *Id.* at 218. On October 14, 2020, the California Supreme Court denied the taxpayers' petition to review that decision. *See* Cal. Code Regs. tit. 18, section 17743 ("The trust is taxable upon . . . all net income . . . from business carried on within this State, from real or tangible personal property located in this State, and from intangible personal property having a business or taxable situs in this State."). *See also* Roxanne Bland, "California's Tangled Trust Tax Laws," *Tax Notes State*, Oct. 19, 2020, p. 295; Andrea Muse, "Appeals Court Rules Trust Taxable on California-Source Income," *Tax Notes State*, July 6, 2020, p. 76.

[15] Cal. Rev. & Tax. Code section 17006.

[16] In *Newcomer v. National City Bank*, 19 N.E.3d 492 (Ohio Ct. App. 2014), however, a California resident individual was the sole member of the advisory committee with the power to direct and consent to investment changes and to remove the Ohio corporate trustee. The Ohio intermediate appellate court did not specify whether the advisory committee served in a fiduciary capacity and did not address whether the advisory committee was a "fiduciary" within the meaning of Cal. Rev. & Tax. Code section 17742(a). *Id.* at 496.

[17] Cal. Rev. & Tax. Code section 17014. *See Appeals of Yolanda King Family Trust and Mary L. Tunney Junior Trust*, 2007 WL 3275357, at *1 (Cal. BOE Oct. 4, 2007) ("Yolanda King and John and Gene Tunney were not California resident 'fiduciaries' for purposes of Revenue and Taxation Code section 17743.").

[18] Cal. Rev. & Tax. Code section 17742(b). *See Ronald Family Trust*, 2000 WL 1137423, at *4 (Cal. BOE May 4, 2000) (Chase California "is a resident of California for purposes of section 17742.").

[19] Kathleen K. Wright, "The Demise of the Incomplete Gift Non-Grantor Trust," *Tax Notes State*, Sept. 18, 2023, p. 911, at 913 (footnote omitted).

[20] Cal. Rev. & Tax. Code section 17743. *See Ronald Family Trust*, 2000 WL 1137423, at *1 ("If Chase California is found to be a California resident, then appellant is liable for California tax on one-half of its taxable income."). In *Newcomer*, 19 N.E.3d 492, the Ohio court did not consider whether the advisory committee, of which a California resident was the sole member, was a fiduciary for purposes of Cal. Rev. & Tax. Code section 17742(a). If the advisory committee did so qualify, 50 percent of the income presumably would have been taxable by California because the other fiduciary — the Ohio corporate trustee — was not a California tax resident.

[21] *See* Cal. Code Regs. tit. 18, section 17743.

[22] Tax return instructions at 5, 25, 27.

[23] FTB Publication 1100, "Taxation of Nonresidents and Individuals Who Change Residency" (rev. Oct. 2024).

[24] Cal. Rev. & Tax. Code section 17742(a).

California income tax. The FTB issued helpful guidance in TAM 2006-0002.[25] The guidance began:

> A resident beneficiary whose interest in a trust is subject to the sole and absolute discretion of the trustee holds a contingent interest in the trust. The exercise of the trustee's discretionary power is a condition precedent that must occur before the beneficiary obtains a vested interest in the trust. Once the trustee decides to distribute income in a specified amount, the beneficiary has a non-contingent, vested interest in the trust, but only for that amount. At that time, the trust is taxable on the distributable income pursuant to Rev. and Tax. Code section 17742. The beneficiary continues to have a contingent interest in the remaining current and/or accumulated income of the trust.[26]

The guidance continued:

> A resident, contingent trust beneficiary of a discretionary trust may have a potential right to current income of the trust and no right to the corpus of the trust. In a discretionary trust if the trustee does not decide to distribute the current year income of the trust to the beneficiary, the income will be accumulated by the trust. This income will be taxable to the trust, pursuant to Internal Revenue Code section (IRC) 641(a) and Rev. and Tax. Code section 17742, in a subsequent taxable year when the trustee decides to distribute some portion of added portion of trust corpus accumulated income [sic] to the resident beneficiary. Once the trustee decides to make a distribution, however, the beneficiary has a vested and non-contingent interest in the accumulated income amount to be distributed.[27]

It went on to advise:

> A resident, contingent trust beneficiary of a discretionary trust may have a potential right to distributions of trust corpus. The trustee's decision (exercise of discretion) to distribute the proceeds from the sale of trust corpus in the current year gives the beneficiary a non-contingent, vested interest in the trust for that amount only. At that time, the trust is taxable on the gain from the disposition of the trust asset pursuant to Rev. and Tax. Code section 17742. If less than all of the sale proceeds are distributed or distributable, the gain should be prorated and the distributable portion is taxable. The beneficiary continues to have a contingent interest in the remaining corpus of the trust.[28]

The technical advice memorandum warned:

> This technical advice memorandum presumes the trustee has complete, unfettered discretion whether and when to make a distribution. However, the trust document should be reviewed in each case to determine any limitations on the trustee's discretion to accumulate income rather than to distribute it to the beneficiary.[29]

The California Court of Appeal, First District, rendered a decision consistent with TAM 2006-0002 in *Steuer*, in which it held that a beneficiary's interest was contingent because the "settlor intended the trustees to have absolute discretion."[30]

The above authorities show that a beneficiary has a contingent interest for purposes of section 17742(a) when their ability to receive trust principal or income is subject to the sole and absolute discretion of the trustee. This leaves open the question whether a beneficiary's interest is contingent when the trustee's power to distribute trust funds is subject to a standard. The tax return

[25] FTB TAM 2006-0002, "Clarification of California Revenue and Taxation Code Section 17742" (Feb. 17, 2006). Effective in the fall of 2024, this and other technical advice memorandums are no longer posted on the FTB's website (see Coffill, "Missing TAMs," CalCPA (Jan. 5, 2025)).

[26] FTB TAM 2006-0002, *supra* note 25, at *2-*3 (footnotes omitted).

[27] *Id.* at *3-*4.

[28] *Id.* at *4.

[29] *Id. See Appeals of Yolanda King Family Trust*, 2007 WL 3275357, at *1 ("Yolanda King was a contingent beneficiary for purposes of Revenue and Taxation Code section 17742.").

[30] *Steuer*, 265 Cal. Rptr. 3d at 227.

instructions are not illuminating on this point because they state:

> A noncontingent or vested beneficiary has an unconditional interest in the trust income or corpus. If the interest is subject to a condition precedent, something must occur before the interest becomes present, it is not counted for purposes of computing taxable income. Surviving an existing beneficiary to receive a right to trust income is an example of a condition precedent.[31]

If the trust provides for distributions to the beneficiary based on a standard (for example, health, education, maintenance, or support), the beneficiary's ability to receive trust funds is subject to a condition precedent — the exercise of the trustee's discretion. However, the trustee's discretion is not sole and absolute. In *Newcomer*, an Ohio intermediate appellate court refused to surcharge a trustee for failing to pay California income taxes for 1970 through 2006.[32] Citing no California authority to support its conclusion, the court held:

> Mr. Lisle's interest in the Trust was contingent and did not create any California income tax liability under [Cal. Rev. & Tax. Code section] 17742(a). Mr. Lisle's interest in the trust was subject to a condition precedent either under the Trust's own terms or by imposition of an ascertainable standard by operation of [Ohio Rev. Code section] 1340.22(B), now re-codified as [Ohio Rev. Code section] 5808.14(B)(1).[33]

For a trust that has resident and nonresident beneficiaries, "the income taxable under Section 17742 shall be apportioned according to the number and interest of beneficiaries resident in this state pursuant to rules and regulations prescribed by the Franchise Tax Board."[34] Guidance was issued and contains examples.[35]

California purports to tax trusts that have noncontingent beneficiaries. It is unclear whether the state always has the power to tax a non-California trustee even if there are noncontingent beneficiaries. The Supreme Court did hold in *Kaestner* that:

> The presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it.[36]

Thus, the beneficial interests at issue in *Kaestner* were contingent. In this regard, the Court noted:

> In limiting our holding to the specific facts presented, we do not imply approval or disapproval of trust taxes that are premised on the residence of beneficiaries whose relationship to trust assets differs from that of the beneficiaries here.[37]

Nevertheless, it should be kept in mind that two earlier Supreme Court decisions —*Brooke*[38] and *Safe Deposit and Trust*[39] — concluded that the receipt of current income by in-state beneficiaries did not warrant imposition of an ad valorem tax on the entire principal held by out-of-state trustees. In *Safe Deposit*, for example, the Court held that Virginia's assessment of a tax on the value of an *inter vivos* trust created by a Virginia domiciliary and having Virginia beneficiaries but a Maryland trustee violated the due process clause. The Court stated:

[31] Tax return instructions at 16.

[32] *Newcomer*, 19 N.E.3d 492.

[33] *Id.* at 514-515.

[34] Cal. Rev. & Tax. Code section 17744.

[35] *See* Cal. Code Regs. tit. 18, section 17744. The regulation specifies that "the trust is taxable upon . . . all income . . . from real and tangible personal property located in this State, and from business carried on within this State and from intangible personal property having a business or taxable situs in this State."

[36] *Kaestner*, 588 U.S. at 270.

[37] *Id.*

[38] *Brooke v. City of Norfolk*, 277 U.S. 27, 28-29 (1928).

[39] *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 93 (1929).

> Here we must decide whether intangibles — stocks, bonds — in the hands of the holder of the legal title with definite taxable situs at its residence, not subject to change by the equitable owner, may be taxed at the latter's domicile in another state. We think not.[40]

The Court confirmed in *Kaestner* that *Safe Deposit* remains good law:

> The State contends that *Safe Deposit* is no longer good law under the more flexible approach in *International Shoe Co. v. Washington* (1945), and also because it was premised on the view, later disregarded in *Curry v. McCanless* (1939), that the Due Process Clause forbids "double taxation." We disagree.[41]

In our view, *Safe Deposit* might provide a basis for concluding that California lacks the power to tax a trust solely because a noncontingent beneficiary is present in the state.

There might be another reason why California cannot tax income of certain trusts — lack of jurisdiction over the trustee. A commentator observed in 2021 that the "Supreme Court has never specifically addressed whether personal jurisdiction and due process nexus are the same."[42] This raises the possibility that a taxpayer might challenge the existence of personal jurisdiction and the existence of due process nexus separately.

In considering whether California has jurisdiction to tax, it's important to remember that a trust is a relationship, not an entity. The trust doesn't pay tax; the trustee does, and it should not be assumed that California has jurisdiction to tax a nonresident trustee. The Supreme Court explained in *Americold Realty Trust*:

> Traditionally, a trust was not considered a distinct legal entity, but a "fiduciary relationship" between multiple people. Such a relationship was not a thing that could be haled into court; legal proceedings involving a trust were brought by or against the trustees in their own name. And when a trustee files a lawsuit or is sued in her own name, her citizenship is all that matters for diversity purposes. For a traditional trust, therefore, there is no need to determine its membership, as would be true if the trust, as an entity, were sued.[43]

In *Breslin*, the California Court of Appeal, Second District, admonished the litigants:

> Trusts are not recognized as legal entities and cannot sue or be sued. Only trustees can be named as parties, thus it is improper to name "The ABC Trust" as a party. (See Prob. Code, sections 17200, subd. (a), 172001.1; see also Code Civ. Proc. section 369, subd. (a)(1).)[44]

Accordingly, California might not have the power to tax a nonresident trustee — even if the trust has noncontingent California beneficiaries — for lack of personal jurisdiction or under the due process clause. Such a trustee might consider filing an action for a declaratory judgment to determine whether the trust is taxable.[45]

Rules of Taxation

Filing Requirements

In California, trustees are cautioned: "*Do not* file Form 541 if there are no California fiduciaries, California noncontingent beneficiaries, or California sourced income."[46] Otherwise, the fiduciary or one of the fiduciaries of a non-grantor trust must file a California return by April 15 of

[40] *Id.* at 93.

[41] *Kaestner*, 588 U.S. at 271 n.6 (citations omitted).

[42] Rick Handel, "The Nexus and Personal Jurisdiction Puzzle," *Tax Notes State*, Nov. 29, 2021, p. 933, at 937.

[43] *Americold Realty Trust v. ConAgra Foods Inc.*, 577 U.S. 378, 383 (2016) (citations omitted).

[44] *Breslin v. Breslin*, 276 Cal. Rptr. 3d 913, 916 (Cal. Ct. App. 2021). *Accord Han v. Hallberg*, 247 Cal. Rptr. 3d 526, 533 (Cal. Ct. App. 2019); *Presta v. Tepper*, 102 Cal. Rptr. 3d 12, 15 (Cal. Ct. App. 2009). In *Jo Redland Trust v. CIT Bank N.A.*, 309 Cal. Rptr. 3d 339 (Cal. Ct. App. 2023), the court permitted the plaintiff to amend the complaint to substitute the name of the trustee for the name of the trust.

[45] *See* Jeffrey A. Friedman, Charles C. Kearns, and Charles C. Capouet, "Expedited Challenges to Unconstitutional State Taxes," *Tax Notes State*, Jan. 26, 2026, p. 271.

[46] Tax return instructions at 5 (emphasis in original).

the following year if the trust has gross income of more than $10,000, net income of more than $100, or alternative minimum tax liability.[47]

Grantor Trust Rules

California adheres to most, but not all, of the federal grantor trust rules. Although a statute provides that "Subchapter J of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to estates, trusts, beneficiaries, and decedents, shall apply, except as otherwise provided,"[48] another statute says:

> When applying any provision of the Internal Revenue Code for purposes of this part [relating to personal income tax], a reference to any of the following is not applicable for purposes of this part:
>
> * * *
>
> (6) A foreign trust, as defined in Section 679 of the Internal Revenue Code.[49]

Accordingly, a trust that is classified as a grantor trust under IRC section 679 is a grantor trust for federal but not for California tax purposes.[50]

Tax Rates

Thanks to Proposition 30 (2012),[51] which increased the top marginal rate to 12.3 percent, and to the additional 1 percent mental health services tax,[52] California taxed trustees on the taxable income (including accumulated ordinary income and capital gains) of non-grantor trusts at rates up to 13.3 percent in 2025 (the 13.3 percent rate applied starting with income over $1 million),[53] and, because of Proposition 55 (2016), the top 13.3 percent rate is scheduled to apply through 2030.[54] If California voters approve Initiative 25-0016 on November 3, 2026, the foregoing rates will become permanent.[55] The state also assesses an AMT equal to 7 percent of the excess of the tentative minimum tax for the tax year over the regular tax for the tax year.[56]

Beginning in 2024 California taxes high-earning taxpayers at rates of up to 14.4 percent. A commentator explained:

> The year kicked off on January 1 with a tax increase on some of the state's high earners because of a change in the payroll tax used to pay for State Disability Insurance (SDI).
>
> Before this year, California residents paid a 0.9 percent SDI tax on wages up to $153,164 in annual income, resulting in a maximum individual contribution of $1,378 annually. Earnings above the $153,164 cap weren't taxed. Under S.B. 951, which was enacted in 2022 and took effect in January, that wage cap was removed, and the tax rate was nudged up to 1.1 percent. The primary effect of the change was on high earners whose SDI tax liability had been capped because of the wage ceiling.

[47] *Id.* at 5, 7. *See* Cal. Rev. & Tax. Code section 18505(e)-(f). *See also In the Matter of the Appeal of Gary M. and Patricia B. Orman Irrevocable Trust 2012*, 2021 WL 1895586, at *3 (Cal. Tax App. Mar. 4, 2021) (Trust with California resident trustees "has not established reasonable cause for failing to timely file the 2014 and 2015 tax returns."); *In the Matter of the Appeal of Merrill L. Mago Trust 14*, 2014 WL 3414962, at *2 (Cal. BOE Mar. 25, 2014) ("The FTB properly imposed the late filing penalty."); FTB Info. Ltr. 2015-02 (Apr. 21, 2015) ("Assuming the [TEXT REDACTED] trust had no California source income and no California resident non-contingent beneficiaries, the trust would still be taxable on the portion of its non-California source income that reflects the proportion of California-resident trustees (of which there is at least one) and non-resident trustees."). Effective January 1, 2018, appeals from the FTB are heard by the California Office of Tax Appeals (OTA) rather than by the California State Board of Equalization (Cal. Gov't Code section 15672). For background, see *Opinion No. 23-701*, 2025 WL 2262382, at *1-*3.

[48] Cal. Rev. & Tax. Code section 17731(a).

[49] Cal. Rev. & Tax. Code section 17024.5(b)(6).

[50] *See* Mark E. Mullin, "Having Your Cake and Eating It Too: California and Federal Hybrid Trusts," *Tax Notes State*, Jan. 13, 2025, p. 81.

[51] Cal. Const. Art. XIII, section 36(f)(2)(A)(iii).

[52] Cal. Rev. & Tax. Code section 17043(a). *See* tax return instructions at 12.

[53] Cal. Const. Art. XIII, section 36(f)(2). *See* Cal. Rev. & Tax. Code section 17041(a)(1), (e), (h), and section 17043(a). *See also* tax return instructions at 9.

[54] Cal. Const. Art. XIII, section 36(f)(2). *See* Cal. Rev. & Tax. Code section 17041(a)(1).

[55] Initiative 25-0016. *See* Paul Jones, "California Initiative on High-Earner Taxes Qualifies for Ballot," *Tax Notes State*, June 22, 2026, p. 915.

[56] *See* Cal. Rev. & Tax. Code sections 17062, 17062.3, 17062.5, 17063. *See also* tax return instructions at 12.

> The change translates into an increase in California's top marginal tax rate on income to 14.4 percent from 13.3 percent for those earning over $1 million. The 14.4 percent rate is a combination of the highest marginal personal income tax rate (12.3 percent), a 1 percent mental health tax, and now the uncapped SDI tax rate of 1.1 percent.[57]

Tax Computation

California imposes taxes on trust income equal to the amount for an individual having the same amount of taxable income.[58] The tax return instructions offer the following guidance:

> There are five different situations that can occur when determining the taxability of a trust. The situations and treatment are:
>
> 1. If the trustee (or all the trustees, if more than one) is a California resident, the trust is taxed on all income from all sources (R&TC Section 17742).
>
> 2. If the noncontingent beneficiary (or all the noncontingent beneficiaries, if more than one) is a California resident, the trust is taxed on all income from all sources (R&TC Section 17742).
>
> 3. If at least one trustee is a California resident and at least one trustee is a nonresident and all beneficiaries are nonresidents, the trust is taxed on all California source income plus the proportion of all other income that the number of California resident trustees bears to the total number of trustees (R&TC Section 17743). Complete Schedule G.
>
> 4. If all of the trustees are nonresidents and at least one noncontingent beneficiary is a California resident and at least one noncontingent beneficiary is a nonresident, the trust is taxed on all California source income plus the proportion of all other income that the number of California resident noncontingent beneficiaries bear to the total number of noncontingent beneficiaries (R&TC Section 17744). Complete Schedule G.
>
> 5. If the trust has resident and nonresident trustees and resident and nonresident noncontingent beneficiaries, both situations 3 and 4 apply. Complete Schedule G.[59]

Computation of tax is quite complicated when a trust has source income, resident and nonresident fiduciaries, and resident and nonresident noncontingent beneficiaries. In that situation, California taxes all the California-source income of the trust, regardless of the residence of the trustees or beneficiaries. After that, the taxation of the non-California-source income depends first on the residences of the trustees and then on the residences of the noncontingent beneficiaries.[60] The tax return instructions give the following illustration:

> Assume that the total taxable income of the trust is $90,000 and is not sourced in California.
>
> There are three trustees, one of whom is a resident of California. There are two noncontingent income beneficiaries, one of whom is a resident of California. The amount of income taxable by California is calculated in the following steps:
>
> 1. Taxable income is first allocated to California by the ratio of the number of California trustees to the total number of trustees. The trustee calculation is 1/3 of $90,000 = $30,000.
>
> 2. The amount allocated to California in that ratio is subtracted from total taxable

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[57] Billy Hamilton, "A Half Year of California Tax Issues," *Tax Notes State*, June 3, 2024, p. 731.

[58] Cal. Rev. & Tax. Code section 17041(e), (a)(1). *See* tax return instructions at 15-16, 27. In *In the Matter of the Appeal of La Paloma Nevada Trust*, 2022 WL 16934769, at *6 (Cal. OTA Aug. 29, 2022), the California OTA ruled that "Appellant failed to establish that the property was held for investment to satisfy the qualified purpose requirement for a tax-free exchange, pursuant to IRC section 1031." *See* Muse, "Trust Property Was Not Held for Investment, California OTA Finds," *Tax Notes State*, Nov. 14, 2022, p. 596.

[59] Tax return instructions at 16.

[60] FTB Legal Ruling 1959-238 (Oct. 27, 1959). *See* tax return instructions at 15-16.

income. The amount for the next allocation is $60,000 ($90,000 - $30,000).

3. The remainder of total income is then allocated to California by the ratio of the number of California noncontingent beneficiaries to the total number of noncontingent beneficiaries. The beneficiary calculation is 1/2 of $60,000 = $30,000.

4. The sum of the trustee calculation and the noncontingent beneficiary calculation is the amount of non-California-source income taxable by California. The trustee income calculation of $30,000 plus the beneficiary income calculation of $30,000 equals the income taxable by California of $60,000.

The apportionment described above does not apply when the interest of a beneficiary is contingent. See R&TC Section 17745 regarding taxability in such cases.[61]

Case Law

Courts have grappled with determining California-source income. In *J.P. Morgan Trust Co.*, the California Court of Appeal, Fourth District, held that "the nonresident trust shareholders of Pabst, a unitary multistate S corporation, are taxed on their pass-through pro rata share of the gain" from the sale of a wholly owned subsidiary.[62] In *Steuer* (2023), the California Court of Appeal, First District, held that "the FTB has not shown there is no triable issue of fact as to the source of the Trust's income."[63] On remand, the trial court held that not all income was sourced to California, but rather that the income was taxable by California only on an apportioned basis, entitling the trustees to a $5.4 million refund.[64]

Other Rules

California permits trustees of non-grantor trusts to take a distribution deduction.[65] The Golden State also allows resident individuals and trustees to take a credit for income taxes paid to other states on non-California-source income.[66] However, not all state taxes are eligible for a credit. The FTB ruled in Legal Ruling 2017-01 that a resident individual "may not utilize the Texas franchise tax paid by R [an S corporation] to Texas to calculate or claim a California [other state tax credit] against [the individual's] California personal income tax liability" because "the Texas franchise tax is not a gross or net income tax."[67]

In California, trustees must make estimated tax payments[68] and must withhold tax from distributions to nonresident beneficiaries in certain circumstances.[69]

The Throwback Tax

California resident beneficiaries are taxed on untaxed income from prior years through a throwback tax:

> If, for any reason, the taxes imposed on income of a trust which is taxable to the trust because the fiduciary or beneficiary is a resident of this state are not paid when due and remain unpaid when that income is distributable to the beneficiary, or in

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[61] Tax return instructions at 16.

[62] *J.P. Morgan Trust Co. of Delaware v. Franchise Tax Board*, 294 Cal. Rptr. 3d 557, 561 (Cal. Ct. App. 2022). *See also* Christopher T. Lutz, "California's Taxation of Sales of Flow-Through Interests," *Tax Notes State*, June 26, 2023, p. 1065; Robert Willens, "Holding Company and Operating Subsidiary Were 'Unitary,'" *Tax Notes State*, Mar. 13, 2023, p. 971; Wright, "The Long Arm of California Stretches Even Farther," *Tax Notes State*, Jan. 30, 2023, p. 435; Willens, "Nonresident Shareholders Taxed on S Corporation's Business Income," *Tax Notes State*, June 27, 2022, p. 1329; Muse, "California Court: Shareholder Gain Apportionable as Business Income," *Tax Notes State*, June 6, 2022, p. 1055.

[63] *Steuer v. Franchise Tax Board*, 2023 WL 5969174, at *9 (Cal. Ct. App. Sept. 14, 2023). *See* Cameron Browne, "California Appellate Court Revives Trustees' Tax Refund Claims," *Tax Notes State*, Sept. 25, 2023, p. 1042.

[64] *Steuer v. Franchise Tax Board*, No. CGC-18-571122 (Cal. Super. Ct. Jan. 22, 2025). *See* Christopher Jardine, "California Trusts Get $5.4 Million Refund on Century Theaters Sale," *Tax Notes State*, Feb. 3, 2025, p. 351.

[65] *See* Cal. Rev. & Tax. Code section 17731(a). *See also* tax return instructions at 10, 15, 25-28.

[66] Cal. Rev. & Tax. Code sections 18001(a), 18003. *See* tax return instructions at 28. *See also* Noonan and Joseph F. Tantillo, "Revelations From a California Resident Tax Credit Case," *Tax Notes State*, Nov. 18, 2024, p. 469. In Legal Ruling 375 (June 11, 1974), the FTB ruled that California residents were entitled to a credit against their California taxes for Minnesota taxes paid by a trust of which they were beneficiaries.

[67] FTB Legal Ruling 2017-01, at 14 (Feb. 22, 2017).

[68] *See* Cal. Rev. & Tax. Code section 19136. *See also* tax return instructions at 8, 12-13.

[69] *See* Cal. Rev. & Tax. Code sections 18662-18677. *See also* Cal. Code Regs. tit. 18, sections 17951-1(c), 17951-2, 17953; tax return instructions at 9.

> case the income is distributable to the beneficiary before the taxes are due, if the taxes are not paid when due, such income shall be taxable to the beneficiary when distributable to him except that in the case of a nonresident beneficiary such income shall be taxable only to the extent it is derived from sources within this state.[70]

A similar rule applies if a California resident beneficiary's contingent interest matures into a noncontingent interest:

> If no taxes have been paid on the current or accumulated income of the trust because the resident beneficiary's interest in the trust was contingent such income shall be taxable to the beneficiary when distributed or distributable to him or her.[71]

The statute goes on to provide: "For purposes of this section income accumulated by a trust continues to be income even though the trust provides that the income (ordinary or capital) shall become a part of the corpus."[72]

The throwback tax is computed based on the year of distribution and up to five prior years:

> The tax attributable to the inclusion of that income in the gross income of that beneficiary for the year that income is distributed or distributable under subdivision (b) shall be the aggregate of the taxes which would have been attributable to that income had it been included in the gross income of that beneficiary ratably for the year of distribution and the five preceding taxable years, or for the period that the trust accumulated or acquired income for that contingent beneficiary, whichever period is the shorter.[73]

Finally, a California resident beneficiary might attempt to escape tax by moving before the year of distribution. Such a beneficiary should keep the following rule in mind:

> In the event that a person is a resident beneficiary during the period of accumulation, and leaves this state within 12 months prior to the date of distribution of accumulated income and returns to the state within 12 months after distribution, it shall be presumed that the beneficiary continued to be a resident of this state throughout the time of distribution.[74]

Whereas the statute contemplates that a person must leave the state, a beneficiary who wants to avoid California tax should commence the arduous process of shedding California tax residency long before a distribution is expected.

Incomplete Gift Non-Grantor Trusts

Often, an asset protection trust is a grantor trust for federal income tax purposes under IRC section 677(a) because the trustee may distribute income to — or accumulate it for — the trustor without the approval of an adverse party. However, clients have used a type of domestic asset protection trust known as the incomplete gift non-grantor trust (ING trust) to eliminate income tax on undistributed ordinary income and capital gains imposed by a state such as California, which follows the federal grantor trust rules, by subjecting distributions to themselves to the control of adverse parties.[75] Unfortunately, effective in 2023, California treats an ING trust as a grantor trust for state income tax purposes under the following statute:

> The income of an incomplete gift nongrantor trust shall be included in a qualified taxpayer's gross income to the extent the income of the trust would be

[70] Cal. Rev. & Tax. Code section 17745(a). If it is invalid for California to tax a trust that has a non-California trustee, then the beneficiary arguably should not be taxable on distributions from that nontaxable trust.

[71] Cal. Rev. & Tax. Code section 17745(b).

[72] Cal. Rev. & Tax. Code section 17745(c).

[73] Cal. Rev. & Tax. Code section 17745(d).

[74] Cal. Rev. & Tax. Code section 17745(e). *See* tax return instructions at 11. The U.S. Supreme Court did not address the validity of the throwback tax structure in *Kaestner*, 588 U.S. 262, 278 n.13 ("The Trust also raises no challenge to the practice known as throwback taxation, by which a State taxes accumulated income at the time it is actually distributed. *See, e.g.*, Cal. Rev. & Tax. Code section 17745(b).").

[75] In 2015 a Delaware institution successfully resisted the FTB's efforts to tax an ING trust, saving the trustor millions of dollars of California income tax. In that case, the FTB initially contended that an improperly drafted ING trust was a grantor trust for California purposes, the trustee successfully petitioned the Delaware Court of Chancery to reform the trust, and the FTB withdrew its objection.

taken into account in computing the qualified taxpayer's taxable income if the trust in its entirety were treated as a grantor trust under Section 17731.[76]

Charitable Remainder Trusts

A charitable remainder trust (CRT) is exempt from federal income tax unless it has unrelated business taxable income.[77] A CRT is subject to California taxation in the same circumstances under the following statute:

> Section 664(c)(2) of the Internal Revenue Code, relating to excise tax, shall not apply and, in lieu thereof, the unrelated business taxable income, as defined in Section 23732, of every charitable remainder annuity trust or charitable remainder unitrust shall be subject to tax under Section 17651.[78]

The tax return instructions require trustees of CRTs to file California Form 541-B.[79]

Planning

To recapitulate, a commentator summarized California's framework for the income taxation of non-grantor trusts in 2023:

> The income of the trust is sourced to and taxed by California if one of three separate criteria [is] met:
>
> - the trust has income from California sources (such as income from real or personal property in the state);
> - a trustee of the trust is a resident of California; or
> - a non-contingent beneficiary of the trust is a resident of California.[80]

She continued:

> In summary, all of a trust's *California-source income* is taxable by California, regardless of where the trust is managed or where the beneficiaries reside. The remaining income of a trust (that is, the non-California source income) will be taxable by California based on a residency theory if the trust has a California resident fiduciary or California resident non-contingent beneficiary. If either all the fiduciaries or all of the non-contingent beneficiaries of a trust are California residents, the trust's income will be wholly taxable by California. If none of the fiduciaries are California residents and there are no [California] non-contingent beneficiaries (only contingent beneficiaries) and there is no California-source income, then there is no California tax liability.[81]

The same commentator advised in a 2016 article:

> Taxpayers should be wary of naming California fiduciaries if they are not prepared to pay the resulting state taxes. Beneficiaries need to be cognizant of when their contingent status vests and they become non-contingent beneficiaries (and taxable on their share of trust income).[82]

The potential benefit of structuring — or restructuring — a trust to escape California income tax will be substantial in many situations. For example, if a non-grantor trust that had a California trustee but no California noncontingent beneficiaries incurred a $1 million long-term capital gain in 2025, had no other income, and paid its California income tax by the end of the year, the trustee would have paid $104,394 of California income tax by December 31, 2025, and $236,120 of federal income tax by April 15, 2026. If the trust had a non-California trustee, however, the trustee would have owed $0 of state income tax and $236,120 of federal income tax, producing a net savings of $104,394.

Because the federal income tax brackets for trusts are much more compressed than those for

[76] Cal. Rev. & Tax. Code section 17082(a). *See* tax return instructions at 5. *See also* Wright, *supra* note 19.

[77] IRC section 664(c).

[78] Cal. Rev. & Tax. Code section 17755. *See* Cal. Rev. & Tax. Code section 17651.

[79] Tax return instructions at 4, 5, 6.

[80] Wright, *supra* note 19 (footnotes omitted).

[81] *Id.* at 913 (footnote omitted) (emphasis in original).

[82] Wright, "The Wacky World of California Trusts," *State Tax Notes*, May 9, 2016, p. 433, at 437.

individuals, some planners mistakenly assume that it is always advantageous to include capital gains in distributions to beneficiaries. But the savings from structuring a trust to minimize California income taxes often exceed the potential federal tax reduction. For example, if a non-grantor trust, which was created by a California resident or nonresident but was not subject to California income tax because it had no California fiduciary or noncontingent beneficiary, incurred a $1 million long-term capital gain in 2025 and had no other income, the trustee would have owed $0 of California income tax on December 31, 2025, and $236,120 of federal income tax on April 15, 2026. However, if the trustee distributed $1 million to a California resident beneficiary (who had no other income) in 2025, the trustee caused the $1 million of long-term capital gain to be included in distributable net income, and the beneficiary paid the California income tax on the distribution by year-end, the beneficiary would have owed $103,135 of California income tax on December 31, 2025, and $196,401 of federal income tax on April 15, 2026. Thus, $103,135 of California income tax was incurred to save $39,642 of federal income tax, producing a $63,493 added tax cost. Note that if the trustee distributed the capital gain but did not include it in distributable net income, California would assert that the capital gain was taxable to the trust because the beneficiary's interest in the amount received was not contingent.[83]

As mentioned above, a planning opportunity might exist as a result of the disconnect between the federal and California grantor trust rules regarding foreign trusts. Hence, if a California resident creates a trust that falls within IRC sections 671-677, the grantor will have to pay federal and California income tax on the trust's income. But California does not classify a foreign trust as a grantor trust as IRC section 679 does for federal purposes. Consequently, if a California resident creates a foreign trust, appoints a non-California trustee, and gives the beneficiaries contingent interests, the trustee must pay federal income tax but not California income tax.

[83]FTB TAM 2006-0002, *supra* note 25.

Unfortunately, this option might be impractical in some situations. IRC section 679(a)(1) provides:

> A United States person who directly or indirectly transfers property to a *foreign trust* . . . shall be treated as the owner for his taxable year of the portion of such trust attributable to such property if for such year there is a United States beneficiary of any portion of such trust.[84]

To create a "foreign trust," a U.S. person must find a foreign court to exercise primary supervision over the administration of the trust or a foreign person to control a substantial decision of the trust.[85] This sometimes might not be easy to do. In addition, foreign trusts involve onerous reporting requirements. For example, in *Bonomo*, a federal district judge in Florida imposed a $20,642.25 civil penalty for the plaintiffs' failure to timely file a Form 3520-A, "Annual Information Return of Foreign Trust With a U.S. Owner," for tax year 2018.[86]

Discredited Early Cases

As mentioned above, California taxes trustees of non-grantor trusts established by California residents and nonresidents based on two criteria — the residences of the fiduciaries and the residences of the beneficiaries. There are old cases holding that California could tax non-California trustees based on the residences of contingent beneficiaries — an approach that the U.S. Supreme Court held unconstitutional in *Kaestner*.[87]

In *McCulloch*,[88] the California Supreme Court held that California could tax the co-trustee/beneficiary on accumulated income distributed to him from a Missouri trust because he was a California resident. The court said:

> We conclude that California could constitutionally tax plaintiff as the

[84]IRC section 679(a)(1) (emphasis added). *See* Jay A. Soled, "Reform the Grantor Trust Rules," 50 *ACTEC L.J.* 249, 269-271 (Spring 2025).

[85]*See* IRC section 7701(a)(31)(B), (30)(E).

[86]*Bonomo v. United States*, 2025 WL 663661, at *3 (S.D. Fla. Mar. 3, 2025).

[87]*Kaestner*, 588 U.S. 262.

[88]*McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964).

resident beneficiary upon the accumulated income when it was distributed to him. But plaintiff in the instant case was simultaneously beneficiary and a trustee. No possible doubt attaches to California's constitutional power to tax plaintiff as a trustee. His secondary role as a trustee reinforces the independent basis of taxing plaintiff as beneficiary.[89]

The U.S. Supreme Court confirmed in *Kaestner* that a state may tax a resident trustee of an otherwise nonresident trust without violating the due process clause.

In *McCulloch*,[90] the California Supreme Court also addressed the taxability of a nonresident trustee based on the residence of a resident contingent beneficiary:

> This case involves the state income tax consequences of a [1951] terminal distribution of the income accumulated by a discretionary trust during the period of the beneficiary's residence in California [1946-1950]. Plaintiff, the beneficiary of the trust and one of the trust's three trustees, protests California's assessment of a tax deficiency upon the accumulated income distributed to him. We find that plaintiff's California residence established sufficient contact of the trust with this state to subject it to California income tax.[91]

Although the individual in question was a trustee as well as a beneficiary, the court held that the "beneficiary's residence . . . in California during this period subjected the trust to liability for state income taxes on its undistributed income."[92]

Following *McCulloch*, in *First National Bank of Chicago*,[93] the California State Board of Equalization ruled that California could tax the nonresident trustees of six trusts being administered in Illinois because all beneficiaries were California residents. The ruling said:

> Appellant also urges that section 17742 (formerly 18102) is unconstitutional if it purports to tax the non-California income of a foreign trust which is administered by a nonresident trustee. This argument has been fully answered by the California Supreme Court in *McCulloch v. Franchise Tax Board*, wherein the court held that California could constitutionally tax a Missouri trust on income which was payable in the future to a beneficiary residing in this state, although such income was actually retained by the trust. The fact that the resident beneficiary was also one of the trust's three trustees was not relied upon by the court in holding that the residence of the beneficiary afforded a constitutionally sufficient connection to bring the trust's income within California's tax jurisdiction.[94]

In *Erdman*,[95] the BOE, following *McCulloch* and *First National Bank of Chicago*, ruled that California could require California resident remainder beneficiaries to pay California tax on accumulated income and capital gains that had not previously been paid by the trustee of two trusts administered in Illinois.

Whatever precedential value the above cases still might have had was eliminated by the U.S. Supreme Court's 2019 *Kaestner* decision, in which it held:

> We hold that the presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it.[96]

The Hellerstein treatise explains why *McCulloch* was wrongly decided in 1964 and why

[89] *Id.* at 421.

[90] *Id.* at 412.

[91] *Id.* at 414.

[92] *Id.* at 415.

[93] *In the Matter of the Appeal of the First National Bank of Chicago*, 1964 WL 1459 (Cal. BOE June 23, 1964).

[94] *Id.* at *3 (citation omitted).

[95] *In the Matter of the Appeal of C. Pardee Erdman*, 1970 WL 2442 (Cal. BOE Feb. 18, 1970).

[96] *Kaestner*, 588 U.S. at 270.

its post-*Kaestner* precedential value is questionable:

> The California court failed to note or explain [in *McCulloch*] the apparent conflict between its ruling and the U.S. Supreme Court's decision in *Safe Deposit & Trust Co.* Moreover, the California court's decision is difficult, if not impossible, to reconcile with *Kaestner Trust*.[97]

Caveat

Discomforting though it may be, trustees in all states probably have a statutory or common-law duty to minimize state income taxes on trusts.[98] In this regard, section 108(b) of the Uniform Trust Code (UTC), a version of which is the law in 30 states, specifies that a "trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration, and the interests of the beneficiaries."[99]

The drafters of UTC section 108 clearly had state income taxes in mind. Thus, UTC section 108's comment notes:

> Locating a trust's principal place of administration will ordinarily determine which court has primary if not exclusive jurisdiction over the trust. It may also be important for other matters, such as *payment of state income tax* or determining the jurisdiction whose laws will govern the trust.[100]

The comment also provides:

> Subsections (c)-(f) provide a procedure for changing the principal place of administration to another state or country. Such changes are often beneficial. A change may be desirable to secure a *lower state income tax rate*, or because of relocation of the trustee or beneficiaries, the appointment of a new trustee, or a change in the location of the trust investments.[101]

Trustees in states — such as California — that haven't adopted the requirement of UTC section 108(b) should not relax because, under the duty to administer the trust in accordance with its terms and applicable law, section 76 of the Third Restatement of Trusts[102] offers the following comment:

> A trustee's duty to administer a trust includes an initial and continuing duty to administer it at a location that is reasonably suitable to the purposes of the trust, its sound and efficient administration, and the interests of its beneficiaries. . . .
>
> Under some circumstances the trustee may have a duty to change or to permit (e.g., by resignation) a change in the place of administration. Changes in the place of administration by a trustee, or even the relocation of beneficiaries or other developments, may result in costs or geographic inconvenience serious enough to justify removal of the trustee.[103]

The potential savings from planning to minimize California income taxes are measurable and substantial. Hence, trustees and their advisers that assume that they don't have to worry about this issue are asking for trouble, especially with several viable tax-minimizing planning options available. In this regard, the plaintiffs in *Newcomer*[104] attempted to surcharge the corporate trustee for its failure to pay California income tax on accumulated trust income from 1970 through 2006.[105] Although the trustee ultimately defeated the claim, it still had to

[97] Jerome R. Hellerstein, Walter Hellerstein, and John A. Swain, *State Taxation*, 20.09[2][a][ii] at 11 (Aug. 2025) (footnote omitted).

[98] For more detailed coverage of this subject, see Richard W. Nenno, Vincent C. Thomas, and Travis G. Maurer, "Yes, Virginia, Trustees Have a Duty to Minimize State Income Taxes on Trusts," 162 *Tr. & Est.* 36 (Dec. 2023).

[99] UTC section 108(b). The text of the UTC and a list of states that have enacted it may be viewed at the Uniform Law Commission website (last accessed July 1, 2026).

[100] UTC section 108 comment (emphasis added). This part of the comment is quoted in the reporter's notes for section 76 of the Third Restatement of Trusts (see *infra* note 103).

[101] UTC section 108 comment (emphasis added).

[102] Restatement (Third) of Trusts section 76 (2003).

[103] Restatement (Third) of Trusts section 76 comment b(2) (cross-references omitted). The reporter's notes for section 76 quote the first portion of the comment under UTC section 108, *supra* note 100.

[104] *Newcomer*, 19 N.E.3d 492.

[105] *Id.* at 511.

litigate the issue — and several others — in an Ohio trial court and the state's intermediate appellate court.

Conclusion

The California income tax can certainly be burdensome in many situations, but that burden can be lessened by judicious use of trusts. Thus, California tax might be eliminated in existing trusts by replacing California fiduciaries with non-California fiduciaries, and reduced by adding non-California fiduciaries to the California fiduciaries. In planning a non-grantor trust, the client might eliminate, reduce, or defer California tax by appointing non-California fiduciaries, by adding non-California fiduciaries to supplement California fiduciaries, or by creating contingent rather than noncontingent interests. In addition, a California resident beneficiary with a contingent interest might work with the trustee to time distributions to occur after the beneficiary has left the state. In planning to escape California income tax, of course, it is essential to ensure that trust income isn't thereby exposed to income tax in one or more other states. Finally, an individual who is subject to taxation on the income of a grantor trust under the federal grantor trust rules might be able to escape California income tax on the same income by qualifying that trust under IRC section 679.[106] ■

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