STATE OF CALIFORNIA
LEGAL DIVISION MS A260
FRANCHISE TAX BOARD
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RANCHO CORDOVA, CA 95741-1720

07.07.2026

Legal Ruling – 2026-01

SUBJECT: Contingent Beneficiaries of Discretionary Trusts Under California Revenue and Taxation Code ("R&TC") section 17742.

ISSUE

Whether, for purposes of R&TC section 17742, a resident beneficiary of a discretionary trust has a contingent or non-contingent interest in a trust.

SITUATION ONE

A is a resident beneficiary who has an interest in a trust that is subject to the sole and absolute discretion of the trustee. The trust has no resident fiduciaries or income derived from sources within California. A receives a current income distribution of the trust at the trustee's discretion.

SITUATION TWO

B is a resident beneficiary who has an interest in a trust that is subject to the sole and absolute discretion of the trustee. The trust has no resident fiduciaries or income derived from sources within California. B has a potential right to the current income of the trust and no right to the corpus of the trust.

SITUATION THREE

C is a resident beneficiary who has an interest in a trust that is subject to the sole and absolute discretion of the trustee. The trust has no resident fiduciaries or income derived from sources within California. The trustee may or does distribute corpus (current year capital gains) to C.

LAW & ANALYSIS

R&TC section 17742(a), provides:

> Except as otherwise provided in this chapter, the income of an estate or trust is taxable to the estate or trust. The tax applies to the entire taxable income of an estate, if the decedent was a resident, regardless of the residence of the fiduciary or beneficiary, and 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, regardless of the residence of the settlor.

In addition, Title 18, California Code of Regulations, Section 17742(b) states:

> A noncontingent beneficiary is one whose interest is not subject to a condition precedent.

R&TC sections 17745(a) and (b), provide:

> (a) 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 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.
>
> (b) 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.

McCulloch v. Franchise Tax Board (1964) 61 Cal.2d 186, 192, states in pertinent part:

> "California taxes the trust on that *portion* of the annual income which the trust holds for eventual distribution to the California resident beneficiary." (Italics added.)

Terms relevant to R&TC section 17742 include the following:

Condition precedent – An event or condition that must occur before the ripening of an interest, right, or claim.[1] If the event or condition does not occur, the interest does not vest.[2] In the context of contracts, a condition precedent is an act or event that must occur before a duty to perform something arises.[3]

Vested – Having become an unconditional and immediate interest or right.[4]

"In law, vesting is the creation of some right, estate, claim, or other legal or equitable interest that from that moment is settled and established; it is not dependent upon a

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[1] See *Condition Precedent*, Bouvier Law Dictionary (Stephen Sheppard ed. 2012).
[2] See *Condition Precedent,* Bouvier Law Dictionary (Stephen Sheppard ed. 2012).
[3] *Int'l Bhd. of Teamsters, Local 396 v. NASA Servs* (2020) 957 F.3d 1038, 1043, citing *Platt Pac., Inc. v. Andelson* (1993) 6 Cal.4th 307, 313.
[4] See *Vesting (Vest or Vested),* Bouvier Law Dictionary (Stephen Sheppard ed., 2012).

condition to be satisfied or an event to occur in order for the party in whom it is vested to enforce it.”[5]

Vested interest – A fixed right to the enjoyment of property, not subject to any condition other than the termination of a precedent estate.[6]

The analyses below presume that the trustee has complete, unfettered discretion whether and when to make a distribution.[7] "Where a trustee has sole and absolute discretion to distribute net trust income to a beneficiary, the beneficiary has a contingent interest in the distribution."[8] In each case, the trust document should be reviewed to determine any limitations on the trustee's discretion to accumulate income rather than to distribute it to the beneficiary. Restatement 2d of Trusts, section 128 Extent of Beneficiary's Interest, states in pertinent part:

> The extent of the interest of the beneficiary of a trust depends upon the manifestation of intention of the settlor…
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> COMMENTS & ILLUSTRATIONS: Comment:
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> *d. Discretionary trusts*. By the terms of the trust it may be provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his discretion shall see fit to pay or apply. In such a case it depends upon the manifestation of intention of the settlor to what extent the trustee has discretion to refuse to make such payment or application. If the settlor manifests an intention that the discretion of the trustee shall be uncontrolled, the beneficiary cannot compel the trustee to make any payment to him or application for his benefit, if the trustee does not act dishonestly or arbitrarily or from an improper motive . . . .

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[5] *Vesting (Vest or Vested),* Bouvier Law Dictionary (Stephen Sheppard ed. 2012).
[6] *Vested interest,* Ballentine's Law Dictionary (Matthew Bender & Co., 3rd ed. 1969).
[7] In *N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Trust* (2019) 588 U.S. 262, 270 ("*Kaestner*"), the Court held 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."

The Court in *Kaestne*r narrowly limited their decision to the specific facts of the case and expressly declined to rule on R&TC section 17742(a).
[8] *Steuer v. Franchise Tax Bd.* (2020) 51 Cal.App.5th 417, 431.

HOLDING ONE

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 the distributed amount. At that time, the trust is taxable on the distributable income pursuant to R&TC section 17742.[9] The beneficiary continues to have a contingent interest in the remaining current and/or accumulated income of the trust.

HOLDING TWO

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. The trust will not be taxable in California on accumulated amounts because the beneficiary's interest is contingent (and because there is no California resident fiduciary and no California-source income.) Once the trustee makes a distribution, the beneficiary has a vested and non-contingent interest in the accumulated income amount to be distributed. The distributions of previously untaxed accumulated income pursuant to R&TC section 17745(b) will be taxable to the beneficiary.

HOLDING THREE

A resident, contingent trust beneficiary of a discretionary trust may have a potential right to distributions of trust corpus, such as capital gains allocated to trust corpus under general rules of trust accounting. The trustee's decision (exercise of discretion) to distribute capital gains from the current year gives the beneficiary a non-contingent, vested interest in the trust for the distributable amount only. At that time, the trust is taxable on the distributable amount pursuant to R&TC section 17742. The beneficiary continues to have a contingent interest in the remaining corpus of the trust.

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[9] California conforms, with modifications, to the federal rules regarding distributable net income. (See R&TC section 17731 for general conformity to Subchapter J of the Internal Revenue Code). Accordingly, in the event a trust becomes taxable by California due to making distributions to an otherwise contingent, resident beneficiary, the trust is likely to claim a distribution deduction for amounts distributed to beneficiaries. In that case, the California resident beneficiary would report the distributions on their personal income tax return.

DRAFTING INFORMATION

The principal authors of this notice are Sonia Woodruff and Sophie Kuehl of the Franchise Tax Board, Legal Division. For further information regarding this notice, contact Ms. Sonia Woodruff at P.O. Box 1720, Rancho Cordova, CA 95741-1720.