

TITLE 280 – DEPARTMENT OF REVENUE

CHAPTER 20 - DIVISION OF TAXATION

SUBCHAPTER 55 - PERSONAL INCOME TAX

PART 7 – Trust Distributions

7.1 Purpose

These rules and regulations implement R.I. Gen. Laws §§ 44-30-5(c) and 44-30-19. Those sections outline the tax treatment of trust distributions.

7.2 Authority

These rules and regulations are promulgated pursuant to R.I. Gen. Laws §§ 44-30-5(c) and 44-1-4. The rules and regulations have been prepared in accordance with the requirements of R.I. Gen. Laws § 42-35-1 *et seq.* of the Rhode Island Administrative Procedures Act.

7.3 Application

These rules and regulations shall be liberally construed so as to permit the Division of Taxation the authority to effectuate the purpose of R.I. Gen. Laws §§ 44-30-5(c), 44-30-19, and other applicable state laws and regulations.

7.4 Severability

If any provision of these rules and regulations, or the application thereof to any person or circumstances, is held invalid by a court of competent jurisdiction, the validity of the remainder of the rules and regulations shall not be affected hereby.

7.5 Reference and Definitions

- A. "Accumulation distribution" has the meaning set out in 26 U.S. Code § 665(b), as amended.
- B. "Discretionary trust" means a trust where the fiduciary has a discretionary power to distribute income or to accumulate income.

- C. "Income" has the meaning set out in 26 U.S.C. § 643(b), as amended.

7.6 Residency Status of Beneficiaries

- A. The status of a beneficiary as a "resident individual" or as a "nonresident individual" is his or her status for personal income tax purposes but determined at the close of the trust's taxable year rather than at the close of the beneficiary's taxable year.
- B. For those children born after the execution of the trust, children of a resident individual are deemed to be resident individuals and; likewise, children of a nonresident individual are deemed to be nonresident individuals.

7.7 Residency Status of the Trust

- A. If income is accumulated in a discretionary trust in any year and the trustee has a discretionary power to distribute the income or the accumulated income among a group of people, any one of whom is a resident individual, the trust is deemed to be a resident trust with regard to the accumulated income pertaining to the resident beneficiary or beneficiaries.
- B. If income is accumulated in a trust in any year, the trust is deemed to be a resident trust for the purposes of the accumulated income to the extent that the income is accumulated for future distribution only to a person who is a (or to persons who are) resident(s) at the close of the trust's taxable year; and is deemed to be a nonresident trust to the extent that the income is accumulated for future distribution to a person(s) who is a nonresident at the close of the trust's tax year.
- C. Capital gains realized and deemed retained for future distribution to the remaindermen are undistributed gains and the trust is deemed to be a resident trust in the same ratio that the interests of all resident individual remaindermen bear to the interests of all remaindermen.

7.8 Examples

- A. Situation A: The will of a resident individual establishes a discretionary trust. During the lifetime of the wife (W), income (except capital gains) may, in the discretion of the trustee, be paid to W, the son (S), the daughter (D) or any issue of S or D, or the income may be accumulated. On W's death, the principal is to be distributed in equal shares to S and D or to the issue of either if S and/or D are not living at that time. Thus, the

trustee has a discretionary power to distribute accumulated income or principal to W, S, D or to any issue of S or of D.

1. During the year all of the income except capital gains is currently paid to W. The trust realizes \$1,000 of long-term capital gains and retains those gains.
 - a. WHAT IF: W and S are Rhode Island residents and D resides in another state and is not a Rhode Island individual?
 - b. ANSWER: Since presumptively the principal will ultimately pass in equal parts to S and D (one of whom is a resident individual and the other is not), the capital gains are therefore being accumulated one-half for a resident and one-half for a nonresident. Thus, one-half of the retained income (capital gains) is subject to Rhode Island personal income tax and a RI-1041 Form is required to be filed. The fact that W is a resident individual is immaterial concerning the capital gains because the principal will eventually go to S and D.
 - c. WHAT IF: W resides in another state and is not a Rhode Island resident; S and D are both Rhode Island resident individuals?
 - d. ANSWER: Since all of the capital gains are being accumulated for future distribution to persons who are Rhode Island resident individuals, the trust is therefore considered a resident trust with respect to the capital gains and a RI-1041 Form is required to be filed as it pertains to the retained income (capital gains).
2. During the year the trust receives \$10,000 of income and realizes \$1,000 in long term capital gains. The trustee pays \$8,000 of income to W; accumulates the remaining \$2,000; and makes no principal distributions.
 - a. WHAT IF: S is a Rhode Island resident individual and W and D both reside in another state and are not Rhode Island resident individuals?
 - b. ANSWER: Since one of the beneficiaries S (who, in the discretion of the trustee) may receive the entire accumulated income, is a resident individual, the trust is considered a resident trust with respect to the income retained. Because

one of the two remaindermen is a resident individual, one-half of the capital gains retained are subject to Rhode Island personal income tax.

- c. WHAT IF: W is a resident of another state and S and D are both Rhode Island resident individuals?
- d. ANSWER: The trust is a resident trust and must report and pay Rhode Island taxes on all the retained income.

B. Situation B: The will of a resident individual establishes a discretionary trust. During W's lifetime, the trustee is authorized, but not required, to pay income (except capital gains) and/or principal in its discretion among a group consisting of W, S, D, the issue of S and the issue of D. On W's death, the trust divides into two separate trusts with S receiving a life income from one with the principal passing to his issue at his death; and D receiving a life income from the other with the principal passing to her issue at her death.

- 1. WHAT IF: During the year the trustee distributes all income and realizes \$2,000 of long term capital gains. W is a Rhode Island resident individual. S is a Rhode Island resident individual as are his minor children. D resides in another state and has two children, a son (GS) who is 22 and a Rhode Island resident individual and a daughter (GD) who resides in the other state.
- 2. ANSWER: Because capital gains are presumptively accumulated for future distribution, the trust is therefore a resident trust with respect to 3/4 of the capital gains. The reasoning behind this is that one half is being accumulated for the benefit of S's issue (all of whom are Rhode Island residents) and one quarter (one half of one half) are being accumulated for GS who is also a Rhode Island resident.

7.9 Resident Beneficiaries' Treatment of Accumulation Distribution by a Trust

A. Rhode Island Income Tax Liability

- 1. The Rhode Island income tax liability for the year in which an accumulation distribution is received is the greater of:
 - a. The Rhode Island income tax liability computed based on the exclusion of the accumulated distribution from Federal

taxable income. Rhode Island taxable income would then be calculated using this adjusted Federal Taxable Income, or

- b. The Rhode Island income tax liability computed based on the Federal taxable income including the amount of accumulation distribution less the beneficiary's allocable portion of the Rhode Island income previously included in RI taxable income of the trust.

B. The Rhode Island Tax Adjustment

1. The Rhode Island tax adjustment is computed as follows:
 - a. Based upon Federal "throw back" rules, determine the preceding years to which the accumulation distribution shall be carried;
 - b. Recompute the Rhode Island personal income tax liability for each year including the accumulation distribution by computing the Federal income tax liability and applying the appropriate Rhode Island rate for that year;
 - c. From the amounts determined in § 7.9(B)(1)(b) of this Part, subtract the original Rhode Island personal income tax liability for the beneficiary for each year to arrive at the difference in Rhode Island income tax attributable to the distribution (not less than zero);
 - d. From the amounts determined in § 7.9(B)(1)(c) of this Part, subtract the Rhode Island income tax previously paid by the trust for each year applicable to the accumulation distribution (not less than zero). If all of the previously taxed income is not distributed, the amount of Rhode Island tax to be subtracted should be in the same proportion as the amount of actual distribution bears to the total accumulated income for that year.
 - (1) If more than one beneficiary is involved, the amount of Rhode Island tax paid to be subtracted shall be that portion of the tax paid that the accumulation distribution received by the beneficiary bears to the total accumulation distribution made to all beneficiaries for that year;

- e. Add the amounts determined in § 7.9(B)(1)(d) of this Part above to arrive at the Rhode Island tax adjustment.

C. Rhode Island Tax Credit

1. To calculate the credit allowable under R.I. Gen. Laws § 44-30-19(a), add together the amount of Rhode Island tax paid by the trust for each applicable year as they appear in § 7.9(B)(1)(d) of this Part.

D. Rhode Island Tax Payable

1. To determine the Rhode Island tax payable for the year, subtract the credit computed in § 7.9(C) of this Part from the tax payable as computed in § 7.9(B) of this Part.
2. This computation is necessary to conform with the limitation discussed in R.I. Gen. Laws § 44-30-19(b).

280-RICR-20-55-7

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Type of Filing: Adoption

Effective Date: 06/11/2018

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