

~~State of Rhode Island – Division of Taxation~~

~~Personal Income Tax~~

~~Regulation PIT 90-01~~

~~Family Education Accounts – Taxpayers~~

~~I. GENERAL~~

~~A taxpayer who sets up a family education account under section 44-30-25 of the Rhode Island General Laws at a qualified depository shall be allowed to modify (reduce) his/her Federal adjusted gross income for Rhode Island income tax purposes by the amount of income earned by such an account.~~

~~II. DEFINITIONS~~

~~A. Family education account means an account created by an individual taxpayer for the purpose of providing qualified educational benefits to a qualified beneficiary, but only if the account is created by the written governing instrument (as prescribed by the Tax Administrator) that designates the account as a Rhode Island family education account and meets the following requirements:~~

- ~~1. The depository is a qualified depository.~~
- ~~2. The assets of the account will not be commingled with other property except in a common trust fund or common investment fund.~~
- ~~3. The account balance shall be deemed to be distributed to the taxpayer not later than the last day of any taxable year of the taxpayer unless the beneficiary remained qualified with respect to such taxpayer on at least one day during the year.~~
- ~~4. In the case where the account's qualified beneficiary is also the taxpayer, no contributions may be made to the account after the taxpayer has attained age 21 and, where the account's qualified beneficiary is not the taxpayer, no contribution to the account may be made unless the beneficiary is a dependent of the taxpayer.~~

~~The family education account has no maximum amount or required term of existence except that the account balance is to be deemed distributed in accordance with A-3 above.~~

~~B. A qualified beneficiary means an individual designated by name or class in the instrument creating the account who is:~~

- ~~1. The taxpayer, or~~
- ~~2. A dependent of the taxpayer as defined in section 152 of the Internal Revenue Code. In the case of an individual whose parents are divorced and who is a dependent of one of such parents, the individual shall be treated as the qualified beneficiary of each parent. A noncustodial parent may therefore establish a family education account for a son or daughter even though the child is claimed as a dependent by the custodial parent.~~

~~No person shall be a qualified beneficiary after obtaining a bachelor's degree, a degree equivalent thereto or any more advanced degree.~~

~~C. Qualified educational benefits means post-secondary education provided by an educational institution which:~~

- ~~1. By virtue of law or charter is a public or other nonprofit educational institution empowered to provide a program of education beyond the high school level, and~~
- ~~2. Which is accredited by a nationally recognized educational accrediting agency or association, and~~
- ~~3. Awards an associate's degree, a bachelor's or advanced degree or provides a program of not less than two (2) years duration which is acceptable for full credit toward a bachelor's degree.~~

~~Trade schools, specialty schools and vocational schools normally do not qualify unless they meet the criteria above.~~

~~D. Cost to provide qualified educational benefits means applicable tuition and fees, room and board charges not in excess of the median amounts charged by institution providing the qualified educational benefits to students living in institution provided housing, fees, books, supplies and equipment required for courses of instruction at such institution.~~

~~E. Qualified withdrawal means any withdrawal from a family education account:~~

- ~~1. The amount of which does not exceed the amount of the cost paid during the taxable year to provide qualified educational benefits to one or more qualified beneficiaries; or~~
- ~~2. Occurring within sixty (60) days after the death of any qualified beneficiary if there is no qualified beneficiary younger than the decedent at the time of his/her death; or~~
- ~~3. To purchase tax exempt bonds issued by the State of Rhode Island having maturity of not more than twenty (20) years from the date of purchase; or~~
- ~~4. Which transfers the entire balance of a particular family education account from one (1) qualified depository to another; or~~
- ~~5. Which transfers all or a portion of the balance of a particular family education account from an account with the name of one (1) qualified or unqualified beneficiary to an account in the name of another qualified beneficiary of the same taxpayer.~~

~~III. WITHDRAWALS~~

~~A. Withdrawals for Qualified Educational Benefits~~

~~Taxpayers must substantiate each qualifying withdrawal by entering the name of the qualifying depository from which the withdrawal was made, the name and address of both the qualified beneficiary for whom the withdrawal was made and the name of the entity to whom payment was made on the RI-1040 FEA form accompanying the taxpayer's Rhode Island personal income tax return.~~

~~B. Transfer Between two Qualified Depositories~~

~~When the taxpayer makes a withdrawal from a family education account for the purpose of transferring funds from that account to another qualified depository, the transfer must be made within sixty (60) days to avoid recapture provisions.~~

~~EXAMPLE: Martha (taxpayer/depositor) wanted to withdraw \$1,000 from her family education account to deposit it in a different qualified depository. Informed that such transfers had to be made within sixty (60) days, she had a bank check made out and deposited the same day in the new qualified depository. Had she taken more than sixty (60) days to deposit it, the amount withdrawn would have been a nonqualified withdrawal subject to recapture.~~

~~C. Death of a Beneficiary~~

~~A withdrawal occurring within sixty (60) days after the death of any qualified beneficiary is a "qualified withdrawal" if there is no qualified beneficiary younger than the decedent at the time of his/her death.~~

~~D. Nonresidents~~

~~If a taxpayer makes a withdrawal from a family education account during a year in which the taxpayer is a nonresident, the withdrawal causes the taxpayer to have a filing requirement for Rhode Island personal income tax purposes even though no tax return would normally be due.~~

~~E. Prohibited Transactions and Collectibles~~

~~Any portion of a family education account used in a prohibited transaction shall be deemed to be withdrawn on the date the portion is so used.~~

~~The term "prohibited transaction" means any transaction which would be described in subparagraph A, B, C, or D of section 4975(D)(1) of the Internal Revenue Code if the term "plan" as used therein included a family education account.~~

~~For example, the lending of money or other extension of credit between a family education account and a fiduciary (i.e., one having any authority or control respecting management of the assets of a family education account) would be a prohibited transaction under section 4975 of the Internal Revenue Code.~~

~~If any portion of the account shall be invested in any collectible as defined in section 408(M)(2) of the Internal Revenue Code, the collectible shall be deemed withdrawn on the first day that any disqualified person obtains physical possession of the collectible.~~

~~The term "disqualified person" includes but is not limited to a fiduciary or any other person providing services to the family educational account.~~

~~"Collectibles" means and includes any work of art, any rug or antique, any metal or gem, any stamp or coin and any alcoholic beverage.~~

~~IV. MODIFICATIONS~~

~~A. Filing Required~~

~~Any modification reducing the taxpayer's Federal adjusted gross income shall not be allowed unless the taxpayer properly completes the family education account form (RI-1040 FEA) and attaches it to his/her Rhode Island personal income tax form on which the modification is made. Taxpayers claiming modification from more than one family education account must complete and submit one form for each account with all appropriate documentation.~~

~~B. Partial Year Residents~~

~~To the extent that the taxpayer had income from a family education account attributable to the period during which he or she was a Rhode Island resident, such income may reduce Federal adjusted gross income.~~

~~EXAMPLE: While a resident, John established a family educational account for his son, George. On August 1, John and his family moved out of Rhode Island. The income earned by the account to the date of the change of residence is subject to the Rhode Island personal income tax. For that year, John was a partial year resident and is entitled to modification of income earned by the family educational account while John was a Rhode Island resident.~~

~~V. RECAPTURE~~

~~A. General~~

~~When an amount is withdrawn or is deemed to be withdrawn other than as a qualified withdrawal, the total amount withdrawn, computed without consideration for what part of the withdrawal may be principal or income, shall be recaptured as a modification increasing the Federal adjusted gross income but not more than the sum of all modifications decreasing Federal adjusted gross income for family education accounts for prior years plus any such modification for the present year. The recapture shall be computed for the year in which the withdrawal was deemed to be made.~~

~~EXAMPLE: In 1989, David established a family education account for his son, Bob. From 1989 to 1995 David remained a Rhode Island resident, made no withdrawals from the account and properly reported income modifications decreasing his Federal adjusted gross income for those seven (7) years totaling \$2,200. In 1996, David had income from the account of \$340 and a nonqualified withdrawal of \$5,000.~~

The nonqualified withdrawal to be recaptured as a modification increasing his Federal adjusted gross income for 1996 is \$2,540 computed as follows:

Modification = lesser of nonqualified withdrawal or (prior years' modifications reducing AGI and present year's modification reducing AGI)

Modification = lesser of \$5,000 or (\$2,200 and \$340)

Modification = lesser of \$5,000 or \$2,540

Modification = \$2,540

B. NONRESIDENTS

If a nonqualified withdrawal is made at a time when the taxpayer is not a Rhode Island resident, the portion of the modification deemed to be Rhode Island source income shall be the amount of the modification multiplied by a fraction, the numerator of which shall be the number of taxable years during which the taxpayer maintained the account and was a resident of Rhode Island and the denominator of which shall be the number of years the taxpayer maintained the account.

EXAMPLE: In 1989 Mary Smith, a Rhode Island resident, set up a family education account for her daughter's college education. From 1989 to 1993 Ms. Smith remained a Rhode Island resident, made no withdrawals from the family education account and properly reported income modifications decreasing her Federal adjusted gross income for those five (5) years totaling \$3,100. In 1994, Ms. Smith had income of \$300 from the account; she made a nonqualified withdrawal of \$10,000 and, in that year, she moved to Florida.

For Rhode Island purposes, Ms. Smith is considered to have Rhode Island source income in the form of a modification increasing her Federal adjusted gross income of \$2,720. This amount is computed in two (2) steps as follows:

1. Modification = lesser nonqualified withdrawals of "prior years' modification reducing AGI and present year's modification reducing AGI)

Modification = lesser of \$10,000 or (\$3,100 and \$300)

2. Rhode Island Source Income = modification x years resident + had account/years had account = \$3,400 x 4 years or \$2,710/5 years

C. Partial Year Residents (a Resident of This State for Less than Twelve (12) Months)

If a nonqualified withdrawal is made during a year in which the taxpayer is a partial year resident for Rhode Island personal income tax purposes, the amount of Rhode Island personal income tax reported as a modification increasing Federal adjusted gross income

~~is calculated in the same manner as that for nonresidents but using the number of months in place of the number of years. Therefore, the calculation would be similar to B above adapted as follows:~~

~~Modification x months resident + had account / months had account~~

~~VI. ESTATE PROVISIONS~~

~~Upon the death of the taxpayer creating a family education account, the account shall not terminate unless otherwise provided by the instrument creating the account and the person entitled to the residue of the family education account (as provided in the instrument creating the account, or if not so provided, as provided in such taxpayer's will or as otherwise provided by law) shall succeed to the rights and obligations of the taxpayer but no person other than a posthumous child of the taxpayer delivered alive within eleven months from the date of the date of the taxpayer's death shall become a qualified beneficiary after the date of the taxpayer's death.~~

~~Any individual who was a qualified beneficiary with respect to the deceased taxpayer shall continue as a qualified beneficiary until such time as such individual would have ceased to be a qualified beneficiary with respect to the taxpayer if:~~

- ~~1. The taxpayer had continued to live;~~
- ~~2. The taxpayer had continued to provide the individual with the same level (adjusted for inflation in the same manner as it described in section 1(j) of the Internal Revenue Code of 1986) of support as the taxpayer provided to the individual in the last taxable year ending before the taxpayer's date of death; and~~
- ~~3. The individual had continued to have as his principal place of abode the taxpayer's home and had remained a member of the taxpayer's household (provided that the individual had the taxpayer's home as his/her principal place of abode and was a member of the taxpayer's household at all times during the period beginning on the first day of the taxpayer's last taxable year ending before the taxpayer's date of death and ending on the taxpayer's date of death).~~

~~VII. MISCELLANEOUS~~

~~A. Income Already Exempt~~

~~Taxpayers placing deposits in a family education account the income from which is already exempt from Rhode Island personal income tax may use only the modification provided by 44-30-25(F) to reduce Federal adjusted gross income.~~

~~B. Netted Modifications~~

~~For a year in which the taxpayer has a modification decreasing Federal adjusted gross income (for income from a family education account) as well as a modification increasing Federal adjusted gross income (for recapture of an unqualified withdrawal~~

~~from a family education account), the taxpayer must report both forms of modification separately (not "netted") on the RI-1040 FEA form accompanying his/her Rhode Island personal income tax return for that tax year.~~

~~C. Multiple Accounts~~

~~Activities, modifications, recaptures and any reporting mandated to be made or calculated shall be made separately for each family education account.~~

~~D. Documentation Requirements~~

~~The acquisition and maintenance of records pertaining to deposits and qualifying depositories, qualifying withdrawals, income, payments, costs, educational institutions, beneficiaries and other pertinent information as substantiation for the provision of 44-30-25 are the responsibility of the taxpayer.~~

~~Documents supporting qualified withdrawals such as, but not limited to, proof of payment for qualified educational benefits or pertaining to qualifications as a beneficiary need not be attached to the form on which the withdrawal is reported but should be retained by the taxpayer as proof that the withdrawal was qualified.~~

~~The lack of documentation may result in denial or reduction of modification or in the determination of nonqualified withdrawal requiring recapture.~~

~~CROSS REFERENCE: REGULATION PIT 90-2, FAMILY EDUCATION ACCOUNTS - QUALIFIED DEPOSITORIES. ALSO SEE FORM RI-1040 FEA.~~

~~R. GARY CLARK
TAX ADMINISTRATOR~~

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