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Issued: February 2003

Reissued: December 1, 2017

## Fiduciary Income Tax - Information Release\*

### IT 2003-02 – Trust Residency

#### *Introduction*

The purpose of this information release is to explain, by way of examples, the definition of "trust residency" as set forth in R.C. 5747.01(l)(3).

The full text of current R.C. 5747.01(l)(3) can be found at: <http://codes.ohio.gov/orc/5747.01>.

#### *Observations/Law*

There are nine independent tests applicable to determine if a trust is a resident trust. R.C. 5747.01(l)(3). If one of the nine tests applies, in whole or in **part**, to a trust for the taxable year, then that trust, or **part of the trust**, is considered to be a **resident trust**.

Generally, Ohio law classifies the income of an irrevocable trust into four distinct categories:

- Qualifying trust amount,
- Qualifying investment income,
- Modified business income, and
- Modified nonbusiness income.

A trust is "irrevocable" to the "extent that the transferor is not considered to be the owner of the net assets of the trust under sections 671 to 678 of the Internal Revenue Code." R.C. 5747.01(l)(3)(b).

**Modified Nonbusiness Income.** The vast majority of trusts will only pay Ohio income tax if they are **resident trusts**, and for most of those trusts, the tax will apply only to those trusts' modified nonbusiness income. **However**, some nonresident trusts are required to pay Ohio income tax on certain modified nonbusiness income having an Ohio situs. R.C. 5747.01(BB)(4)(c)(ii). In general, modified nonbusiness income is the trust's income and gain that are earned and accumulated on investments not related to a business activity conducted by the trust (either by direct ownership of a business or by indirect ownership of a business via an equity investment in a pass-through entity). R.C. 5747.01(BB)(3). Some examples of modified nonbusiness income include Ohio Lottery Commission winnings and gains from sale of Ohio real estate.

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\* An information release does not create legal obligations by its own force. Only an administrative rule can "confer the force of law on a requirement." See *Progressive Plastics, Inc. v. Testa*, 133 Ohio St.3d 490, 2012-Ohio-4759.

**Qualifying Beneficiary.** Many of the trust residency tests rely on the presence of a “qualifying beneficiary.” For trusts other than charitable lead trusts, a qualifying beneficiary is any potential current beneficiary other than a beneficiary to which a contribution would qualify for the IRC §170 charitable contribution deduction. See R.C. 5747.01(l)(3)(c) and IRC §1361(e)(2). For charitable lead trusts, a qualifying beneficiary is any current, future, or contingent beneficiary other than a beneficiary to which a contribution would qualify for the IRC §170 charitable contribution deduction.

### *Guidance*

If, for the taxable year, any one of the following nine tests applies to the trust (or part of the trust), then the trust (or part of the trust), is a resident trust. A trust’s residency **is not** determined based on the location of either the trustee or the administration of the trust’s assets. It is possible that more than one residency test can apply to all or a portion of a trust.

- 1) **Testamentary Trusts.** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if both of the following are true:
  - Property was transferred to a testamentary trust because of a decedent’s death; and
  - At the time of the testator's death, the testator of that testamentary trust was domiciled in Ohio for purposes of Ohio's estate tax.

R.C. 5747.01(l)(3)(a)(i) and 5747.01(l)(3)(e)(i). There is no requirement that any beneficiary be domiciled in Ohio.

**Example.** Because a testator's death, real estate is transferred by will to the trustee of a testamentary trust created by the will of the testator who, at the time of death, was domiciled in Ohio for purposes of Ohio's estate tax. The entire trust is a resident trust, even if no beneficiary is domiciled in Ohio.

- 2) **Transferor Domiciled in Ohio at Time of Transfer to Irrevocable Trust.** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if both of the following are true:
  - At the time property was transferred to an irrevocable trust, the transferor was domiciled in Ohio for purposes of Ohio's individual income tax; and
  - For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(ii). The transferor of the property need not be the creator of the trust, and the transferor's domicile when the trust became irrevocable is irrelevant to this test.

**Example.** Individual A created a trust that became irrevocable while A was not domiciled in Ohio for purposes of Ohio's individual income tax. Thereafter, A moved to Ohio and, while domiciled in Ohio for purposes of Ohio's individual income tax, transferred property with a fair market value of \$900 to the irrevocable inter vivos trust. Immediately prior to the transfer, the trust net assets had a fair market value of \$100. During some portion of the trust's current taxable year, at least one qualifying beneficiary is domiciled in Ohio for purposes of Ohio's individual income tax. The trust is a resident trust for the current taxable year with respect to 90% of the trust's modified nonbusiness income (90% is the proportion of the trust attributable to the property A transferred to the trust while domiciled here).

- 3) ***Transferor Domiciled in Ohio When Trust Became Irrevocable.*** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if both of the following are true:
- When the trust document/instrument became irrevocable, the transferor of the property was domiciled in Ohio for purposes of Ohio's individual income tax; and
  - For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(ii). The transferor of the property need not be the creator of the trust.

The transferor's domicile when the property was transferred to the trust does not matter. With regard to property previously transferred to an inter savors trust that remained revocable until the transferor's death, the first requirement is met if, immediately preceding the transferor's death, the transferor was domiciled in Ohio for purposes of Ohio's individual income tax.

***Example.*** While domiciled outside Ohio for purposes of Ohio's individual income tax, individual A created a revocable inter savors trust and immediately funded the trust with \$1,000,000. Several years later, A moved to Ohio and remained domiciled in Ohio for purposes of Ohio's individual income tax until A's death, when the trust became irrevocable. During some portion of the trust's current taxable year at least one qualifying beneficiary is domiciled in Ohio. The entire trust is a resident trust for the current taxable year.

- 4) ***Third Party Transfer Became Irrevocable While Creator Domiciled in Ohio.*** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if all the following are true:
- Prior to the decedent's death, the decedent created an inter savors trust while the decedent was domiciled in Ohio for purposes of Ohio's individual income tax;
  - Prior to the decedent's death, the inter savors trust became irrevocable while the decedent was domiciled in Ohio for purposes of Ohio's individual income tax;
  - Because of the decedent's death, property was transferred to the irrevocable inter savors trust; and
  - For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(i), 5747.01(l)(3)(e)(ii), and 5747.01(l)(3)(f)(i). The transferor of the property need not be the creator of the trust.

***Example.*** While domiciled in Ohio for purposes of Ohio's individual income tax, individual A created a revocable inter savors trust and funded the trust with \$10. Some time thereafter, the inter savors trust became irrevocable while A remained domiciled in Ohio for purposes of Ohio's individual income tax. Subsequently, A permanently left Ohio for employment in another state. A's out-of-state employer purchased and owned a life insurance policy insuring A's life. The policy named as primary beneficiary the trustee of A's then-irrevocable inter savors trust. After A's death, the insurance company remitted the life insurance proceeds to the trustee. During some portion of the trust's current taxable year, at least one qualifying beneficiary is domiciled in Ohio. The entire trust is a resident trust for the current taxable year.

- 5) ***Third Party Transfer Became Irrevocable While Decedent Domiciled in Ohio.*** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if all the following are true:
- Prior to the decedent's death and while the decedent was domiciled in Ohio for purposes of Ohio's individual income tax, the decedent transferred property to an inter savors trust;

- Prior to the decedent's death, the inter savors trust became irrevocable (if it wasn't at the time of creation) while the decedent was domiciled in Ohio for purposes of Ohio's individual income tax;
- Because the decedent's death, property was transferred to the irrevocable inter savors trust; and
- For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(i), 5747.01(l)(3)(e)(ii), and 5747.01(l)(3)(f)(ii). The transferor of the property need not be the creator of the trust.

**Example.** While domiciled outside Ohio for purposes of Ohio's individual income tax, individual A created a revocable inter savors trust and funded the trust with \$10. Some time thereafter, A moved to Ohio and became domiciled in Ohio for purposes of Ohio's individual income tax. While A was domiciled in Ohio for purposes of Ohio's individual income tax and while A's parents were not, A's parents contributed \$20,000 to the trust. For federal tax purposes, the contribution was treated as a gift to the creator and a transfer by the creator to the trust. Ohio follows this treatment. Shortly after that transfer, the trust became irrevocable while A remained domiciled in Ohio for purposes of Ohio's individual income tax. A subsequently moved outside Ohio and was no longer domiciled here. After that move, A's parents purchased and owned a \$1,000,000 life insurance policy on A's life. The policy named as primary beneficiary the trustee of A's then-irrevocable inter savors trust. A died and the insurance company remitted the life insurance proceeds to the trustee. During some portion of the trust's current taxable year, at least one qualifying beneficiary is domiciled in Ohio. The entire trust is a resident trust for the current taxable year.

- 6) **Third Party Payment on Account of Pre-death Contract with Decedent.** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if all the following are true:
- On account of a decedent's death, property was transferred to an irrevocable inter savors trust;
  - The transfer occurred as a result of a contractual relationship between the transferor and either the decedent or the estate of the decedent;
  - At the time of the decedent's death, the decedent was domiciled in Ohio for purposes of Ohio's estate tax; and
  - For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(i), 5747.01(l)(3)(e)(ii), and 5747.01(l)(3)(f)(iii). The transferor of the property need not be the creator of the trust.

**Example.** Individual A, with no ties to Ohio, created a revocable inter savors trust and funded the trust with \$10. Subsequently, A moved to Ohio. At the time of A's death, the trust became irrevocable while A was domiciled in Ohio for purposes of Ohio's estate tax. Pursuant to A's retirement plan beneficiary designation, the out-of-state financial institution that was the custodian for A's Keogh plan remitted the entire fund amount to the trustee of the then-irrevocable inter savors trust. During some portion of the trust's current taxable year, at least one qualifying beneficiary is domiciled in Ohio. The entire trust is a resident trust for the current taxable year.

- 7) **Third Party Payment on Account of Pre-death Contract with Another Person.** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if all the following are true:

- On account of a decedent's death, property was transferred to an irrevocable inter saviors trust;
- The property transfer occurs as a result of a contractual relationship between the transferor and another person;
- At the time of the decedent's death, that other person was domiciled in Ohio for purposes of Ohio's individual income tax; and
- For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(i), 5747.01(l)(3)(e)(ii), and 5747.01(l)(3)(f)(iv). The transferor of the property need not be the creator of the trust.

**Example.** Individual A, with no ties to Ohio, created a revocable inter saviors trust and funded the trust with \$10. Subsequently, A's sibling, also with no ties to Ohio, purchased and owned a life insurance policy insuring A's life. The policy named as primary beneficiary the trustee of A's inter saviors trust. Later, A's sibling moved to Ohio and was domiciled in Ohio for purposes of Ohio's individual income tax at the time the trust became irrevocable upon A's death. The insurance company remitted the life insurance proceeds to the trustee of the then-irrevocable inter saviors trust. During some portion of the trust's current taxable year, at least one qualifying beneficiary is domiciled in Ohio. The trust, except the fair market value of the net assets stemming from the original \$10 transfer, is a resident trust for the current taxable year.

- 8) **Pour-over Transfer.** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if all the following are true:
- On account of a decedent's death, property was transferred to an irrevocable inter saviors trust;
  - The transfer occurs on account of the will of the testator; and
  - For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(i), 5747.01(l)(3)(e)(ii), and 5747.01(l)(3)(f)(v). The transferor of the property need not be the creator of the trust. The statute does not require that the testator be domiciled in Ohio at any time.

**Example.** While domiciled outside Ohio, individual A created a revocable inter saviors trust and funded the trust with \$10. A subsequently moved to Ohio and, at the time of A's death, the inter saviors trust became irrevocable while A was domiciled in Ohio for purposes of Ohio's estate tax. A's will contained a "pour over" provision directing the representative of A's estate to transfer \$300,000 cash to the trustee of the then-irrevocable trust. During some portion of the trust's current taxable year, at least one qualifying beneficiary is domiciled in Ohio. The entire trust is a resident trust for the current taxable year.

- 9) **Court-created Trust.** A trust, in whole or in part, is a resident trust for Ohio income tax purposes if all the following are true:
- On account of a decedent's death, property was transferred to an irrevocable inter saviors trust;
  - The trust was created by, or caused to be created by, a court because of the death of an individual;
  - At the time of the individual's death, the individual was domiciled in Ohio for purposes of Ohio's estate tax; and
  - For all or some portion of the trust's current taxable year, at least one of the trust's qualifying beneficiaries is domiciled in Ohio for purposes of Ohio's individual income tax.

R.C. 5747.01(l)(3)(a)(i), 5747.01(l)(3)(e)(ii), and 5747.01(l)(3)(f)(vi). The court creating the trust need not be an Ohio court for this test to apply.

**Example.** Individual A died because of a two-car automobile accident in Michigan. At the time of A's death, A was domiciled in Ohio for purposes of Ohio's estate tax. A's minor children commenced litigation in Michigan against the driver of the other automobile. The Michigan court awarded damages of \$1,000,000 and, because the plaintiffs were minors, created a trust for the benefit of the children. During some portion of the trust's current taxable year, at least one qualifying beneficiary is domiciled in Ohio. The entire trust is a resident trust for the current taxable year.

### *Questions?*

Taxpayers may visit [www.tax.ohio.gov](http://www.tax.ohio.gov). Questions may be submitted by clicking on the "Contact" link found at the top right of the page and then choosing the "Email Us" option. Taxpayers with additional questions regarding this subject may contact Business Taxpayer Services at 1-888-405-4039.