2019

The Supreme Court, Due Process and State Income Taxation of Trusts

Bridget J. Crawford
Elisabeth Haub School of Law at Pace University

Michelle S. Simon
Elisabeth Haub School of Law at Pace University

U.C.L.A. Law Review

The Supreme Court, Due Process and State Income Taxation of Trusts

Bridget J. Crawford and Michelle S. Simon

ABSTRACT

What are the constitutional limits on a state's power to tax a trust with no connection to the state, other than the accident that a potential beneficiary lives there? The Supreme Court of the United States will take up this question this term in the context of *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*. The case involves North Carolina's income taxation of a trust with a contingent beneficiary, meaning someone who is eligible, but not certain, to receive a distribution or benefit from the trust, who resides in that state. Part I of this Article explains the background of *Kaestner Trust* and frames the constitutional questions that will be before the Court at oral arguments on April 16, 2019. Part II examines how and why due process applies in the state income taxation context, with a particular emphasis on how familiar concepts of general and specific jurisdiction apply uneasily to donative trusts. Part III articulates the reasons that the Court should hold that a state has no constitutional authority to impose a tax on trust income where the trust's only connection with the forum state is the residence of a contingent beneficiary. *Kaestner Trust* is the most important due process case involving trusts that the Court has decided in over sixty years; it bears directly on the fundamental meaning of due process.

AUTHORS

Bridget Crawford is the James D. Hopkins Professor of Law at the Elisabeth Haub School of Law at Pace University. Michelle Simon is a Professor of Law and the Dean Emerita of the Elisabeth Haub School of Law at Pace University.

TABLE OF CONTENTS

> Truth is stranger than fiction, but it is because Fiction is obliged to stick to possibilities; Truth isn't.
>
> –*Pudd'nhead Wilson's New Calendar*[1]

INTRODUCTION

Tic-tac-toe.[2] Snap, crackle, pop.[3] Larry, Curly, and Moe.[4] Peas porridge hot.[5] Certain words seem to roll off the tongue naturally in threes. For some lawyers and lucky individuals, this list of common verbal triads includes the words "grantor, trustee, and beneficiary." In the most general sense, a trust is a beneficial arrangement in which a grantor transfers assets to a trustee for the benefit of one or more beneficiaries.[6] In the case of a transfer to an irrevocable trust—one that the grantor cannot change or undo—the grantor typically has no further control over the trust property. The terms of the trust agreement dictate how the trust will operate and specify which state's law will govern the administration and interpretation of the trust instrument.[7] However, a trust's governing law provision is not outcome-determinative for income tax purposes. State X may choose to impose a tax on a trust's income if the trust is created under the will of a decedent domiciled in that state, if the trust is administered in the state, if the trustee resides in or does business in the state,[8] if some or all of the trust assets are located in the

1. MARK TWAIN, FOLLOWING THE EQUATOR: A JOURNEY AROUND THE WORLD 156 (1897) (epigraph to Chapter 15). Pudd'nhead Wilson is a fictional lawyer in a small town who produces a calendar with idiosyncratic quotations; local townspeople consider him a simpleton, or "pudd'nhead." *See* MARK TWAIN, PUDD'NHEAD WILSON AND THOSE EXTRAORDINARY TWINS (1894).
2. *See, e.g.*, Klay Kruczek & Eric Sundberg, *A Pairing Strategy for Tic-Tac-Toe on the Integer Lattice With Numerous Directions*, 15 ELECTRONIC J. COMBINATORICS 1 (2008).
3. *See, e.g.*, *Snap, Crackle & Pop*, KELLOGG'S RICE KRISPIES, https://www.ricekrispies.com/en_US/snap-crackle-pop.html [https://perma.cc/B4DP-FC8R] (dating first appearance of the cereal advertising slogan to 1929).
4. *See, e.g.*, Robert Gardner & Robert Davidson, *Hypothesis Testing Using the Films of the Three Stooges*, 32 TEACHING STAT. 49 (2010).
5. *See, e.g.*, FLORENCE WARREN BROWN & NEVA L. BOYD, OLD ENGLISH AND AMERICAN GAMES FOR SCHOOL AND PLAYGROUND 44 (1915).
6. *See, e.g.*, ROBERT H. SITKOFF & JESSE DUKEMINIER, WILLS, TRUSTS, AND ESTATES 385 (10th ed. 2017).
7. *See* UNIF. TRUST CODE § 107 (UNIF. LAW COMM'N 2000) (providing that a trust's governing law is "the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue").
8. This is the approach taken by New York, for example. *See* N.Y. TAX LAW § 605(b)(3)(D) (McKinney 2018) (imposing no tax on a trust if no trustees are

state, or if a trust beneficiary resides in the state.[9] Alternately, State X may choose to not tax the income at all.[10]

Generally speaking, an irrevocable trust is taxed only once—as an entity. That is, unless the grantor has retained certain powers over the trust property, the trust is treated for income tax purposes as an entity separate from the person who created it.[11] The trustee will pay tax on any income the trust earns (or accrues) and retains.[12] To the extent that the trustee distributes trust income out to a beneficiary, the beneficiary will pay tax on that income and the trustee will not.[13] Unique challenges arise in taxing an irrevocable trust when the trust has significant relationships with multiple jurisdictions, when the trust has any beneficiary with a contingent interest, or when the trust has multiple beneficiaries in different jurisdictions. For example, if a trust with a trustee domiciled in State X has mandatory income beneficiaries located in State Y, it may be that the trust is subject to income taxation in both State X and State Y.

While the Supreme Court of the United States has previously upheld the constitutionality of multiple states' imposing a wealth transfer tax on the same item,[14] it has yet to address a case in which two or more states seek to impose income tax the same item of trust income. The Court also has not yet addressed the constitutionality of imposing an income tax on a trust's contingent beneficiary, meaning someone who is eligible, but not certain, to receive a distribution or benefit from the trust. In many modern trusts, the trustees have discretion—but no obligation—to pay trust income or principal to a named beneficiary or a member of a class of beneficiaries. Logically, if the trustee resides in State X, the trust assets are located in State X, the trust's situs is State X, and the contingent trust beneficiary, although residing in State Y, never receives a distribution from the trust, one would think that such State Y would not have sufficient minimum contacts to impose a tax

---

domiciled in that state, the trust has no source income from New York, and no trust property is located in the state).

9. This is the approach taken by North Carolina, Tennessee, Georgia, and California. *See generally* RICHARD W. NENNO, BASES OF STATE INCOME TAXATION OF NONGRANTOR TRUSTS (2019).

10. This is the approach taken by Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. *See generally id.*

11. *But see* 26 U.S.C. §§ 676, 677 (2012) (providing that where grantor of inter vivos trust retains certain rights over trust property, such as the right to substitute trust property, all items of trust income be treated as belonging to the grantor).

12. JEROME R. HELLERSTEIN, WALTER HELLERSTEIN & JOHN A. SWAIN, STATE TAXATION ¶ 20.09 (3d ed. 2018).

13. *Id.*

14. Curry v. McCanless, 307 U.S. 357, 372 (1939) (permitting both Alabama and Tennessee to impose tax on testamentary transfer of intangible property under will of Tennessee domiciliary passing to trustee located in Alabama).

on trust income that the beneficiary has not received and is not certain to receive at any time in the future. The Supreme Court will now take up these questions in *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*.[15] The Court will hear oral arguments on April 16, 2019, with a decision expected sometime in June.[16] *Kaestner Trust* is the most important due process case involving trusts that the Court has decided in over sixty years.[17]

Part I of this Article explains the factual background and procedural posture of the *Kaestner Trust* case and frames the constitutional questions that are before the Court.[18] Part II examines how and why due process applies in the state income taxation context, with a particular focus on how the familiar concepts of general and specific jurisdiction apply uneasily to donative trusts. Part III articulates the reasons that the Court should hold that a state has no constitutional authority to impose a tax on trust income where the trust's only connection with the forum state is the residence of a contingent beneficiary.

I. BACKGROUND: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST

A. The Long Path to the Supreme Court

On December 30, 1992, under a single umbrella irrevocable trust agreement, Joseph Kee Rice III created three separate share trusts, with one for the benefit of each of his three children and their descendants.[19] The umbrella trust agreement explicitly states that New York law governs the terms of each separate share trust.[20]

At the time of trust creation, both Mr. Rice and the initial trustee were residents of and domiciled in New York.[21] On the basis of the residence of the

15. N.C. Dep't of Revenue v. Kimberly Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (mem.).
16. *Supreme Court of the United States October Term 2019, [Monthly Argument Calendar] for the Session Beginning April 15,* 2019, https://www.supremecourt.gov/oral_arguments /argument _calendars/MonthlyArgumentCalApril2019.pdf [https://perma.cc/253D-UZCY] [hereinafter *Monthly Argument Calendar*].
17. The last significant trust case involving state due process claims was *Hanson v. Denckla*. Hanson v. Denckla, 357 U.S. 235 (1958) (holding that Florida, the state of the decedent's domicile, had no jurisdiction over Delaware trustees of a testamentary trust).
18. *See infra* Part I.
19. Complaint ¶¶ 11–12, 14, 17, Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015) [hereinafter Complaint] (No. 12-CVS-8740), 2012 WL 12282023, *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
20. Complaint, *supra* note 19, ¶ 15.
21. *Id.* ¶ 13.

trustee, the trust was subject to income taxation in the state of New York.[22] At that time, no descendants of Mr. Rice were domiciled in or maintained a residence in North Carolina.[23] Some years later, in 1995, Mr. Rice moved to Florida.[24] In 1997, Kimberley Rice Kaestner, Mr. Rice's daughter and a beneficiary of one of the separate share trusts, moved to North Carolina.[25] She and her children continuously resided in North Carolina throughout the tax years in question, 2005 to 2008.

Pursuant to the terms of the trust agreement, the trustee was to distribute all of the separate share trust property to Kimberley Rice Kaestner upon her attaining the age of forty on June 2, 2009. Prior to this time, however, neither Ms. Kaestner nor any of her descendants were entitled to any income or principal from the trust.[26] In fact, the trustee did not make any discretionary distributions from the trust.[27] During this time, the trustee did, however, make loans from the trust in order to allow Ms. Kaestner to make certain business investments and to cover a capital call on a limited partnership interest held in another trust.[28]

North Carolina imposes an income tax on any trust for the benefit of a North Carolina resident (as well as residents outside of North Carolina if certain other conditions are met).[29] North Carolina makes no distinction between beneficiaries who actually receive trust income and beneficiaries who merely might (but do not in fact) receive trust income.[30] In other words, according to North Carolina, the fact that a contingent income beneficiary resides in-state is sufficient for the trust to become subject to state income tax, regardless of whether the discretionary income beneficiary receives any distribution of income from a trust that otherwise has no connection with North Carolina.

For the tax years 2005 through 2008 inclusive (before Ms. Kaestner's fortieth birthday), the trustee filed a fiduciary income tax return in North Carolina and paid

22. *Id. See also* N.Y. TAX LAW § 605(b)(3)(D) (McKinney 2018) (imposing income tax based on residence of trustee in New York).
23. Complaint, *supra* note 19, ¶ 12.
24. *Id.* ¶ 16.
25. *Id.* ¶ 17.
26. Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 2015 WL 1880607, at *2 (N.C. Super. Ct. Apr. 23, 2015) (No. 12-CVS-8740), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
27. Complaint, *supra* note 19, ¶ 23.
28. Kaestner, 2015 WL 1880607, at *2.
29. N.C. GEN. STAT. ANN. § 105-160.2 (West 2017) (imposing tax on taxable income of estates and trusts where beneficiary is North Carolina resident or, in the case of a nonresident beneficiary, if trust income derives from North Carolina sources).
30. *See id.* (imposing tax on taxable income of estates and trusts based on beneficiary's residence in-state).

tax on the accumulated and undistributed trust income.[31] In 2012, the trustee then filed a refund claim for more than $1.3 million paid during those tax years.[32]

The trustee argued for a refund on two grounds. First, the trustee claimed that the North Carolina tax statute is unconstitutional because it violates the Due Process Clause of the Fourteenth Amendment (and its state counterpart).[33] Under the United States Supreme Court's decision in *Quill Corp. v. North Dakota*,[34] which, in 2012, was the most current guidance on the relationship between state taxation and interstate commerce, the Due Process Clause requires (1) "some definite link, some minimum connection, between a state and a person, property or transaction it seeks to tax;" and (2) "that the income attributed to the state for tax purposes . . . be rationally related to values connected with the taxing state."[35] The trustee of the Kimberley Rice Kaestner Trust asserted that North Carolina lacked minimum contacts with the trust.[36] The trustee himself resided outside of North Carolina, the trust property and the trust situs were located outside of the state,[37] the trust assets had never been distributed to anyone located in North Carolina, and the trustee had not done anything to "avail [the trust] of the benefits and protections of North Carolina."[38] Thus, the trustee argued, North Carolina's tax law clearly violated the Due Process Clause.[39]

The trustee's second argument was that North Carolina's tax law violates the Commerce Clause of Article I of the U.S. Constitution.[40] The Commerce Clause requires a substantial nexus between the taxed entity or person and the state, an apportionment of the tax to the degree of activity connected to the state, a fair relationship between the tax and the services provided by the state, as well as nondiscrimination against interstate commerce.[41] The *Kaestner Trust* trustee claimed that North Carolina failed all of these requirements. Most importantly, the

31. Complaint, *supra* note 19, ¶ 22.
32. *Id.* ¶¶ 24–25; Kaestner, 2015 WL 1880607, at *1.
33. Complaint, *supra* note 19, ¶¶ 5–6. *See* U.S. CONST. amend. XIV, § 1.
34. Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (limiting conditions in which states may impose tax on interstate commerce).
35. Kimberley Rice Kaestner 1992 Family Tr. v. N. Carolina Dep't of Revenue, 2015 WL 1880607, at *4 (N.C. Super. Ct. Apr. 23, 2015) (No. 12-CVS-8740), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
36. Complaint, *supra* note 19, ¶¶ 37–38, 43.
37. *Id.* ¶ 37.
38. *Id.* ¶¶ 37–38.
39. *Id.* ¶¶ 36–40.
40. *Id.* ¶¶ 5–6. *See* U.S. CONST. art. I, § 8, cl. 3 (reserving to Congress the sole power to regulate commerce among the states).
41. *See, e.g.*, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

trustee asserted that North Carolina lacked a "substantial nexus" with the trust.[42] Furthermore, according to the trustee, any state income tax was not fairly apportioned among the jurisdictions that did have a nexus with the trust, the North Carolina income tax discriminated against interstate commerce, and the trust did not receive services from the state in fair proportion to the tax the trust paid.[43]

Having attacked the North Carolina statute on these two constitutional bases, the trustee then moved for summary judgment, which the Superior Court of North Carolina, Wake County, granted.[44] The trial court reasoned that summary judgment was appropriate for two reasons. First, the trial court found that the North Carolina law violated the Due Process Clause because the trustee had no physical presence in the state, the trust had no assets located in the state, and there was nothing to suggest that the trustee had ever attempted to avail the trust of any benefit under North Carolina law.[45] Although the North Carolina Department of Revenue opposed the motion by arguing that the trustee conducted activity in the state by consulting with Ms. Kaestner from time to time, the court emphasized that the trustee, and not Ms. Kaestner, had sole and absolute discretion over the trust assets.[46] Even the loans by the trustee to Ms. Kaestner were not of the type of "sufficient contact" or "purposeful" activity on the part the trust such that the undistributed trust income could be subject to taxation under North Carolina law.[47] Therefore, the court found that the trust did not have the necessary minimum contacts with North Carolina to satisfy the elements of due process.[48]

The trial court also analyzed the Commerce Clause claim, citing to *Quill's* requirement that a business have a physical presence in the jurisdiction for the business to have the "substantial nexus" with the state as required by the Commerce Clause.[49] The trial court found that North Carolina lacked a substantial nexus with

---

42. Complaint, *supra* note 19, ¶ 43.
43. *Id.* ¶ 42. The trustee also asserted related violation of the North Carolina State Constitution. *Id.* ¶¶ 46–49.
44. Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 2015 WL 1880607, at *12 (N.C. Super. Ct. Apr. 23, 2015) (No. 12-CVS-8740), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
45. *Id.* at *5.
46. *Id.* at *6.
47. *Id.*
48. *Id.*
49. *Id.* at *9. *See also* Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (limiting conditions in which states may impose tax on interstate commerce).

the trust and that the state's income tax was not "fairly related" to the services provided to the trust.[50]

On appeal, the Court of Appeals of North Carolina affirmed the lower court's grant of the trustee's motion for summary judgment.[51] Applying the standard that a North Carolina court may only declare a law unconstitutional when the violation is "plain and clear," meaning its unconstitutionality "is demonstrated beyond a reasonable doubt," the Court of Appeals found that the trust lacked the minimum contacts with North Carolina to make it subject to the state's tax laws.[52] Because the Court of Appeals found that the North Carolina law did not meet the requirements of due process, it declined to address the constitutionality of the tax under the Commerce Clause.[53]

Still not deterred, the North Carolina Department of Revenue appealed its case to the North Carolina Supreme Court.[54] The state's highest court affirmed the lower courts' grant and affirmation of summary judgment for the trustee, finding that North Carolina did not have minimum contacts with the trust.[55] The North Carolina Department of Revenue then petitioned the Supreme Court of the United States for a writ of certiorari.[56] North Carolina cited a split between four state courts that have held that in-state residence of a trust beneficiary is a sufficient basis on which a state may impose income tax on a trust, and five state courts that have held that such taxes violate the Due Process Clause.[57] The Supreme Court granted the petition.[58] The Court will hear oral arguments on April 16, 2019.[59] A decision is likely by the end of June, 2019.

50. Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 2015 WL 1880607, at *9 (N.C. Super. Ct. Apr. 23, 2015) (No. 12-CVS-8740), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
51. Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
52. *Id.* at 648–51.
53. *Id.* at 651.
54. *Id.*
55. Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
56. Petition for Writ of Certiorari, Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015) (No. 12-CVS-8740)
57. Petition for Writ of Certiorari, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 2018 WL 4942045 at *9 (2018) (No. 18-457) (noting a conflict between, on the one hand, courts in the four states of California, Missouri, Connecticut, and Illinois that permit taxation of trusts based on a contingent beneficiary's in-state residency, and, on the other hand, courts in the five states of New York, New Jersey, Michigan, Minnesota, and North Carolina that prohibit states from taxing trusts based on a contingent beneficiary's in-state residence).
58. N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (mem.).

B. The Major Tax Issue Before the Supreme Court of the United States

The question that the Supreme Court will address in *Kaestner Trust* is what constitutes sufficient "minimum contacts" between a trust and a jurisdiction for tax purposes. Constitutionally permissible bases for trust taxation may include that the trust is created under the will of a decedent domiciled in that state, that the trust is administered in or has assets located in the state, that the trustee resides in or conducts trust business in the state, or that a beneficiary resides in the state.[60] But where the trustee does not actually distribute any trust property to a contingent beneficiary, it is not obvious that the beneficiary's residence alone constitutes a sufficient connection to pass constitutional muster. The Court will address the question under a due process framework, not under the Commerce Clause, because neither the Court of Appeals nor the Supreme Court of North Carolina reached the Commerce Clause question in *Kaestner Trust*.[61] Furthermore, the trustee seems to have abandoned this line of argument after the state appellate court failed to address it.[62]

In evaluating *Kaestner Trust*, commentators may be tempted to refer to the Supreme Court's ruling in *South Dakota v. Wayfair, Inc.*,[63] issued shortly after the North Carolina Supreme Court in 2018 struck down as unconstitutional the state income tax on a trust with a North Carolina contingent beneficiary. The *Wayfair* decision partially overruled the Court's earlier judgment in *Quill*, and held that under the Commerce Clause, a state could impose a sales tax on a retailer that lacked a traditional physical presence in the jurisdiction.[64] Because the *Wayfair* decision rested entirely on Commerce Clause grounds,[65] its tolerance for taxation in the absence of a taxpayer's lack of physical presence in the jurisdiction

59. *Monthly Argument Calendar*, *supra* note 16.
60. *See supra* notes 8–10 and accompanying text.
61. *See supra* note 53 and accompanying text.
62. *See, e.g.*, Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
63. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).
64. *See* Quill Corp. v. North Dakota, 504 U.S. 298 (1992). The *Wayfair* Court upheld the South Dakota law against a Commerce Clause challenge and overruled *Quill* in part. *Wayfair*, 138 S. Ct. at 2080. In *Wayfair*, the Court ruled that laws imposing state sales tax on nonresident sellers with zero physical presence in the jurisdiction are valid under the Commerce Clause "so long as [they] (1) appl[y] to an activity with a substantial nexus with the taxing State, (2) [are] fairly apportioned, (3) do[] not discriminate against interstate commerce, and (4) [are] fairly related to the services the State provides." *Id.* at 2091 (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).
65. *Id.* at 2080.

does not control the result in the *Kaestner Trust* case. *Kaestner Trust* is strictly a due process case. As noted by the *Quill* court (in a portion not overruled by *Wayfair*), challenges to a state tax regime under the Commerce Clause and the Due Process Clause may be related but are distinct.[66] A state's tax may be consistent with the Due Process Clause but violate the Commerce Clause, although the reverse is not true.[67] Any tax that violates the Due Process Clause will necessarily will violate the Commerce Clause, because the lack of due process operates as a per se undue burden on interstate commerce.[68] Thus, in *Kaestner Trust*, the important question is whether North Carolina has the "minimum contacts" required by the Due Process Clause.[69]

II. DUE PROCESS AND STATE INCOME TAXATION OF TRUSTS

The Supreme Court previously has addressed the issue of trust taxation in *Safe Deposit Tr. Co. v. Virginia*.[70] In that case, Virginia sought to impose an intangibles tax on a trust sited in Maryland with a Maryland trust company as trustee.[71] The trust had no assets located in the Commonwealth of Virginia, although the trust's grantor and two discretionary beneficiaries were domiciled in Virginia.[72] The Court reasoned in the *Safe Deposit* case that because the trust had its situs and assets in Maryland, and the beneficiaries were domiciled Virginia, allowing Virginia to impose a tax on the trust assets would require the Court to adopt "the irrational view that the same securities were within two states at the same instant and because of this to uphold a double and oppressive assessment."[73] The Court did not root its *Safe Deposit* decision in specific constitutional grounds, but rather in the more general, basic principles of the Fourteenth Amendment that limit a state's ability to tax items only within its jurisdiction or control.[74]

Because *Kaestner Trust* presents as a due process case, the question is what test will apply in determining whether a state tax system meets the specific requirements of that portion of the Fourteenth Amendment.[75] Limiting its analysis to Commerce Clause grounds, the Court in *Wayfair* acknowledged that state tax

66. *Quill*, 504 U.S. at 304.
67. *Id.*
68. *Id.* at 305–06 (citing Int'l Harvester Co. v. Dep't of Treasury, 322 U.S. 340, 353).
69. *Kaestner*, 2015 WL 1880607, at *9.
70. Safe Deposit & Tr. Co. v. Virginia, 280 U.S. 83 (1929).
71. *Id.* at 89–91.
72. *Id.* at 92.
73. *Id.* at 94.
74. *Id.* at 92.
75. *See* U.S. CONST. amend. XIV.

systems must also meet the requirement of due process principles.[76] Indeed, the *Wayfair* Court suggested that state income tax nexus for Commerce Clause purposes should be evaluated under due process principles, and *Quill* required some physical presence in the forum state in order for due process to be satisfied.[77]

Because a corporation is a mere legal construct with no inherent physical attributes, the *Quill* Court reasoned that a corporation's "minimum contacts" must come in the form of in-state acts or property maintained in the state.[78] Without minimum contacts, a state could not fairly tax a corporation.[79] Because trusts, like corporations, are creatures of the law, the *Quill* reasoning as relates to the due process analysis (undisturbed by *Wayfair*) should extend to donative trusts as well.[80] Fundamental fairness is the standard by which state income taxation of trusts should be judged for due process purposes.[81]

The same issue—determining a corporation's presence in a jurisdiction—spurred the development of the Court's due process jurisprudence in the personal jurisdiction area, beginning with the foundational case of *International Shoe Co. v. Washington.*[82] The Court in *Quill*, in a portion of the decision undisturbed by *Wayfair*, recognized that *International Shoe* and its progeny are relevant to the state tax inquiry because the inquiries into state tax and personal jurisdiction due process are "comparable."[83] In determining that a corporation could be subject to personal jurisdiction in a foreign state by virtue of its contacts with that state, the Court in *International Shoe* articulated the due process standard commonly known as the "minimum contacts test."[84] To satisfy due process, the corporation must have minimum contacts with the state such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice."[85] By parity of reasoning, the same "minimum contacts" should extend to the state taxation arena as well.

76. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2093 (2018) ("When considering whether a State may levy a tax, Due Process and Commerce Clause standards may not be identical or coterminous, but there are significant parallels.").
77. *Id.* (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).
78. Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992)
79. *Id.*
80. *See supra* note 6 and accompanying text.
81. *See Quill*, 504 U.S. 298.
82. Int'l Shoe Co. v. Washington, 326 U.S. 310 (1945).
83. *Quill*, 504 U.S. at 307–08.
84. *Int'l Shoe*, 326 U.S. at 316.
85. *Id.* The Court in *Quill* stated "[b]uilding on the seminal case of *International Shoe* . . . we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice''" 504 U.S. at 307 (citations omitted).

Because a similar inquiry is applied to state taxation, personal jurisdiction jurisprudence merits further analysis. Personal jurisdiction breaks down into two types: general jurisdiction and specific jurisdiction.[86] States have general jurisdiction over a defendant individual or corporation when that defendant has a large degree of contact with that forum state—a corporation that is incorporated in that state or does business in that state, or a human being who is domiciled in that state, for example.[87] Thus, the defendant's operations within a state are so substantial that it justifies a lawsuit against it "on causes of action [that] arise from dealings entirely distinct from those activities."[88] States have specific jurisdiction over a defendant individual or corporation when the degree of contact is minimal, but the cause of action arises from that isolated contact.[89] In either situation, those contacts must satisfy due process, which calls for an analysis of whether the contacts between the defendant and the forum are of a quality and nature such that it is fair and reasonable for the nonresident to be subject to suit there.[90] This analysis is fairly straight forward in general jurisdiction situations because general jurisdiction rests upon the premise that because the corporation or individual has substantial contacts with the forum state and has benefitted from the protections of the forum, it is not unreasonable to require that the defendant submit to jurisdiction there. The analysis of specific jurisdiction is more difficult, however, because the corporation or individual has a more limited connection with the forum state. Thus, it is more complicated to find contacts between the defendant and the forum state that do not offend traditional notions of fair play and substantial justice. The specific jurisdiction analysis involves balancing the interests of the plaintiff, the defendant, and the forum state.[91]

---

86. *See generally* Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408 (1984) (finding no general jurisdiction and holding that specific jurisdiction violates due process).
87. *See generally* Daimler AG v. Bauman, 571 U.S. 117 (2014).
88. *Int'l Shoe*, 326 U.S. at 318.
89. *See* Gray v. Am. Radiator & Standard Sanitary Corp., 176 N.E. 2d 761 (1961) (referring to Illinois legislature's drafting of the first specific jurisdiction statute). Following the decision in *International Shoe*, states began to enact "long-arm" or specific jurisdiction statutes. *See, e.g.*, *id.* Generally, an individual or corporation could be amenable to personal jurisdiction in that state if the cause of action arises out of that individual's or corporation's contact with the forum state. *See also* World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286 (1980) (describing the due process limitations of specific jurisdiction).
90. *Int'l Shoe*, 326 U.S. at 316–19.
91. *Id.* Since the decision in *International Shoe*, the Supreme Court has tried to refine and clarify the standard for determining whether due process is satisfied. *See generally* McGee v. Int'l Life Ins. Co., 355 U.S. 220 (1957); Hanson v. Denckla, 357 U.S. 235 (1958); Shaffer v. Heitner, 433 U.S. 186 (1977); World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 298 (1980); Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985);

In cases involving state taxation of trusts, the principal challenge comes from the fact that a trust is not a traditional legal person; it is neither a human being nor a corporation. It is an arrangement for holding property that splits legal title and equitable title.[92] The Supreme Court itself has stated that a donative trust is "not a thing that can be haled into court; legal proceedings involving a trust [are] brought by or against the trustees in their own name."[93] A trust does not exist in corporeal form; there can be no personal jurisdiction over a trustee (the legal owner of trust property) unless the trustee is present in the jurisdiction.[94] For that reason, if a state seeks to impose tax on the basis of the residence of a contingent beneficiary who may never receive trust assets, the question is whether the state has the requisite contacts required under due process to tax the trust.

The requirements for due process would appear to be met in the case of a trust with a trustee resident or domiciled (as in the case of a human being) or conducting business (as in the case of a bank or trust company) in a particular state. In *Hanson v. Denckla*,[95] a resident of Pennsylvania had established a trust in Delaware, naming a Delaware bank as trustee. The trust grantor then moved to Florida. Shortly before her death, she changed the beneficiaries of the trust from her children to her grandchildren. Upon grantor's death, the remainder of the trust passed to her grandchildren, the designated beneficiaries. The grantor's children brought an action in Florida, alleging that the change of beneficiaries was ineffective, and that the children were the real beneficiaries of the trust. The Supreme Court of Florida held that it had property jurisdiction over the trust and that the change indeed had been ineffective. Yet before the Florida court rendered judgment, the grandchildren commenced an action in Delaware, seeking to have themselves declared as the beneficiaries of the trust, which the court granted. In determining which state—Florida or Delaware—properly had jurisdiction over the trust, the Supreme Court of the United States held that the trust did not have sufficient contacts with Florida, and so Florida courts could exercise no jurisdiction over the trust. The Court explained that the trustee, a trust company, "has no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in

Asahi Metal Indus. Co. v. Superior Court, 480 U.S. 102 (1987); Burnham v. Superior Court, 495 U.S. 604 (1990); J. McIntyre Machinery, Ltd., v. Nicastro, 564 U.S. 873 (2011); Goodyear Dunlop Tires Operations, S.A. v. Brown, 564 U.S. 915 (2011); BNSF Ry. Co. v. Tyrrell, 137 S. Ct. 1549 (2017).

92. *See supra* note 6 and accompanying text.
93. Americold Realty Tr. v. Conagra Foods, Inc., 136 S. Ct. 1012, 1016 (2016).
94. *Id.*
95. *Hanson*, 357 U.S. 235.

that state, either in person or by mail."[96] As the Court suggests in *Hanson v. Denkla*, the requirements of due process might be met if the trustee conducts substantial administrative activity in the jurisdiction, or maintains trust assets in the jurisdiction.[97] All of these situations are examples of the trust's having sufficient activity within the state, properly becoming subject to personal jurisdiction (and thus income taxation under the same analysis).

In the case of a trust that specifically invokes the laws of a particular jurisdiction in naming its situs, the trust properly would be subject to personal jurisdiction in the forum state (in addition to possibly being subject to taxation in the jurisdiction where it conducts substantial activity). While the contacts between the trust and the forum are isolated in the latter case, the cause of action, or ability to tax, arises out of those contacts. Due process would be satisfied because the interests of the forum state are very strong when its laws govern the trust. But the mere residence of potential—not actual—trust beneficiaries in the state, without additional forms of contact, likely does not rise to the level of activity that would trigger personal jurisdiction and thus income tax liability. The contacts between the trust and the forum state would be too tenuous to be of a quality and nature that it would be fair and reasonable for the trust assets to be taxed by that state. Taxation would hinge on the possibility that a trustee might make a discretionary decision to make a distribution from the trust, when the beneficiary has no control over this decision.

III. HOW THE SUPREME COURT WILL RULE (AND WHY IT MATTERS)

In light of the minimum contacts requirements of *International Shoe*,[98] the Supreme Court likely will rule in *Kaestner Trust* that a state's taxation of a trust based solely on a contingent income beneficiary's residence in that state violates the Due Process Clause.[99] A discretionary beneficiary's interest is too speculative to give rise to the minimum contacts that are required under the reasoning and spirit of *International Shoe*.[100] Allowing taxation based on the residence of a contingent beneficiary would eviscerate any common-sense understanding of "minimum contacts;" it would allow a state to tax on the basis of what might occur, not on the facts as they are. There would be seemingly no logical limit to the reach of such a tax system.

96. *Hanson*, 357 U.S. at 251.
97. *Id.*
98. Int'l Shoe Co. v. Washington, 326 U.S. 310 (1945).
99. *See supra* note 33.
100. *Id.*

If the Court concludes that North Carolina lacks the ability to tax nonresident trusts with resident discretionary beneficiaries, then Tennessee also will need change its law before the already-scheduled phase out in 2021 of that feature of the tax law.[101] (Tennessee is the only other jurisdiction that taxes trusts based on the in-state residence of a contingent beneficiary.[102]) In North Carolina and Tennessee, government officials should expect that a Supreme Court ruling in favor of the trustee in *Kaestner Trust* will trigger a flood of refund requests for tax years that are still open. Because this may represent a real strain on state budgets, it is possible that the Court could declare its ruling to be prospective only. There is nothing to suggest that this is under consideration in *Kaestner Trust* in particular, but it is an approach that the Court has taken in other cases.[103]

Because there is no uniformity among state income taxation of trusts, it is true that any particular trust may avoid taxation entirely. This might be because the trust is sited in a jurisdiction without an income tax, or in a jurisdiction that the trustee *ex ante* can determine will not impose a tax based on factors under the trustee's control such as the trustee's residence or domicile, where the trust conducts its administrative and other activity, the location of the trust situs or the location of the trust assets.[104] Therefore jurisdictions that do impose tax on income actually distributed out to beneficiaries may want to revise their laws as follows. In the year of the distribution, that state should tax not only distributions of current income, but any distributions that are attributable to previously accumulated income, even if the income had been added to trust principal (so as to avoid the problem of some income escaping taxation entirely by means of an accounting sleight-of-hand).[105] Ultimately, a decision of the Supreme Court in favor of the trustee in *Kaestner Trust* may spur states to finally adopt some a uniform law for trust income taxation to make trust "situs shopping" less attractive, bringing greater stability to trust drafting and administration.[106]

101. *2018 Guidance for Tennessee's Hall Income Tax Return*, TENN. DEP'T REVENUE (July 12, 2017), https://www.tn.gov/content/dam/tn/revenue/documents/taxguides/ indincguide.pdf [https://perma.cc/F3FX-X8L8].
102. *See* NENNO, *supra* note 9.
103. *See, e.g.*, Sessions v. Morales-Santana, 137 S. Ct. 1678 (2017) (making changes to derivative citizenship rules on a prospective basis only).
104. *See supra* notes 8–10 and accompanying text.
105. This would be similar to the existing tax laws of California, for example. *See* CAL. REV. & TAX CODE § 17745 (West 2019).
106. A Multistate Tax Commission took up, but ultimately abandoned for lack of consensus, a project to create a uniform tax law for trusts and estates. *See, e.g.*, *Trusts Work Group*, MULTISTATE TAX COMM'N, http://www.mtc.gov/Uniformity/Project-Teams/Trusts-Work-Group [https://perma.cc/F6ZW-3ABX].

CONCLUSION

Justice Harry Blackmun famously said that he knew he was "in the doghouse" with the Chief Justice if he received an assignment to write the opinion in a tax case.[107] But *Kaestner Trust* is no dog of a case. It broadly implicates basic principles of due process. There are many reasons to allow each state to implement its own tax (and strong arguments in favor of a more uniform approach),[108] but it would be fundamentally unfair to require a trust to pay income tax to a jurisdiction solely on the basis of the residence of a discretionary trust beneficiary who does not actually receive any trust distributions. Once the beneficiary receives trust income, it is reasonable in all respects to subject that income to taxation. The Court's decision in *Kaestner Trust* will have lasting impact on the future of due process jurisprudence.

Ultimately, trusts are creatures of legal fiction. They exist because the law tolerates the idea that it is possible to split legal and equitable title to property. Trusts are not the inevitable consequence of some right to control property; their existence reflects the acceptance of the story of split ownership. In the case of trust law, fiction is already strange enough. State income taxation should hew close enough to material reality that a trust is taxed only when the trust has some meaningful connection with the jurisdiction. An accident of fate—such as where a wholly discretionary beneficiary decides to live—should not trigger income taxation.

107. Stuart Taylor, Jr., *Reading the Tea Leaves of a New Term*, N.Y. TIMES, Dec. 22, 1986, at B14 (quoting J. Blackmun).
108. *See supra* note 106 and accompanying text.