

## Publications

### Supreme Court Holds State May Not Impose Tax on Trust Income Based Solely on Residency of In-State Beneficiary

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In *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, Case No. 18-457, 588 U.S. \_\_ (2019), the Supreme Court held that states may not impose a tax on trust income based solely on the residency of an in-state beneficiary.

#### FACTS

Kimberley Rice Kaestner (“Kaestner”), a North Carolina resident, was the beneficiary of a trust. The trust was created by Kaestner’s father, a New York resident, and administered by a trustee who was also a New York resident. The trust documents and records were maintained in New York, and the custodian of the trust assets was located in Massachusetts. The trustee made no direct investments in the state of North Carolina and held no real property there.

Under the terms of the trust, the trustee had absolute discretion to distribute the trust’s income and principal to the beneficiary. Although Kaestner did not receive any distributions of income or principal during the years at issue, the North Carolina Department of Revenue assessed a tax on all income generated by the trust for tax years 2005 through 2008. The tax was premised on a North Carolina statute, which imposed a tax on the income of any trust “for the benefit of” a North Carolina resident. The trustee paid the tax under protest and sued in state court.

#### ANALYSIS

The Supreme Court applied a two-step analysis to determine the constitutionality of the state tax under the Due Process Clause of the Fourteenth Amendment. First, the Court considered whether there was “some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.” Second, the Court looked at whether the income attributed to the state for tax purposes was rationally related to “values connected with the taxing State.”

Focusing primarily on the minimum connection required under the first step, the Court asserted that where the residence of a beneficiary is the only contact with the state, the Court will look to “the extent of the in-state beneficiary’s right to control, possess, enjoy, or receive trust assets.” The Court analyzed both the terms of the trust document and how the trust was administered, and found that North Carolina lacked the minimum connection necessary to support its tax.

Concluding that the trust income at issue could not be taxed by North Carolina, the court relied on the following facts: (1) the North Carolina beneficiary did not receive any income from the trust, (2) the North Carolina beneficiary had no right to demand trust income, and (3) the North Carolina beneficiary could not count on ever receiving income from the trust.

While the majority opinion suggests that any of the above factors could result in sufficient contacts to permit a state to tax the trust, both the majority and concurring opinions caution that the *Kaestner* decision is applicable only to the specific facts at issue in the case. Thus, the Supreme Court reached a narrow holding, determining that a state tax premised *solely* on the in-state residency of a beneficiary violates the Due Process Clause of the Fourteenth Amendment and is unconstitutional.

If you have questions concerning the implications of the *Kaestner* decision on the administration of your trust, contact your Vorys attorney.