Trusts Go to Washington: North Carolina Dept. of Revenue v. Kaestner Family Trust

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IN THE SUPREME COURT OF NORTH CAROLINA

No. 307PA15-2

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THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST

v.

NORTH CAROLINA DEPARTMENT OF REVENUE

On discretionary review pursuant to N.C.G.S. § 7A-31 of a unanimous decision of the Court of Appeals, ___ N.C. App. ___, 789 S.E.2d 645 (2016), affirming an opinion and order of summary judgment dated 23 April 2015 entered by Judge Gregory P. McGuire, Special Superior Court Judge for Complex Business Cases appointed by the Chief Justice pursuant to N.C.G.S. § 7A-45.4, in Superior Court, Wake County. Heard in the Supreme Court on 11 October 2017.

Moore & Van Allen PLLC, by Thomas D. Myrick, Neil T. Bloomfield, Jonathan M. Watkins, and Kara N. Bitar, for plaintiff-appellee.

Joshua H. Stein, Attorney General, by Matthew W. Sawchak, Solicitor General, Tenisha S. Jacobs, Special Deputy Attorney General, and James W. Doggett, Deputy Solicitor General; and Law Office of Robert F. Orr, by Robert F. Orr, for defendant-appellant.

JACKSON, Justice.

In this case we consider whether defendant North Carolina Department of Revenue could tax the income of plaintiff The Kimberly Rice Kaestner 1992 Family Trust pursuant to N.C.G.S. § 105-160.2 solely based on the North Carolina residence of the beneficiaries during tax years 2005 through 2008. Because we determine that

plaintiff did not have sufficient minimum contacts with the State of North Carolina to satisfy due process requirements of the Fourteenth Amendment to the United States Constitution and Article I, Section 19 of the Constitution of North Carolina, we conclude that the taxes at issue were collected unconstitutionally and, therefore, affirm the decision of the Court of Appeals affirming the North Carolina Business Court's 23 April 2015 Opinion and Order on Motions for Summary Judgment in favor of plaintiff.

As the Business Court noted, the underlying, material facts of this case as established by the evidence in the record are not in dispute. The Joseph Lee Rice, III Family 1992 Trust was created in New York in 1992 for the benefit of the children of the settlor Joseph Lee Rice, III pursuant to a trust agreement between Rice and the initial trustee, William B. Matteson. In 2005 Matteson was replaced as trustee by David Bernstein, who was a resident of Connecticut. Bernstein remained in the position of trustee and remained a Connecticut resident during the entire period of time relevant to this case. The trust was and is governed by the laws of the State of New York, of which Rice was a resident. No party to the trust resided in North Carolina until Rice's daughter and a primary beneficiary of the trust, Kimberly Rice Kaestner, moved to North Carolina in 1997.

On 30 December 2002, the trust was divided into three share sub-trusts one each for the benefit of Rice's three children, including Kaestner. The sub-trusts were divided into three separate trusts in 2006 by Bernstein for administrative

convenience. Plaintiff is the separate share trust formed for the benefit of Kaestner and her three children, all of whom resided in North Carolina during the tax years at issue.

During the tax years at issue, the assets held by plaintiff consisted of various financial investments, and the custodians of those assets were located in Boston, Massachusetts. Documents related to plaintiff such as ownership documents, financial books and records, and legal records were all kept in New York. All of plaintiff's tax returns and accountings were prepared in New York.

None of the beneficiaries of plaintiff had an absolute right to any of plaintiff's assets or income because distributions could only be made at the discretion of Bernstein, who had broad authority to manage the property held by plaintiff. No distributions were made to beneficiaries in North Carolina, including Kaestner, during the tax years at issue; however, in January 2009, plaintiff loaned $250,000 to Kaestner at Bernstein's discretion to enable her to pursue an investment opportunity. This loan was repaid.

The terms of the original trust provided that the trustee was to distribute the trust assets to Kaestner when she reached the age of forty. Before her fortieth birthday on 2 June 2009, Kaestner had conversations with her father and Bernstein about whether she wished to receive the trust assets on that date. Ultimately, she requested to extend the trust, and accordingly, Bernstein transferred the assets of

plaintiff into a new trust, the KER Family Trust, in 2009. That transfer occurred after the tax years at issue, and KER Family Trust is not a party to this case.

In managing plaintiff, Bernstein provided Kaestner with accountings of trust assets, and she received legal advice regarding plaintiff from Bernstein and his firm. Kaestner and her husband also met with Bernstein in New York to discuss investment opportunities for the trust and whether Kaestner desired to receive income distribution as set forth in the original trust agreement.

During tax years 2005 through 2008, defendant taxed plaintiff on income accumulated each year, regardless of whether any of that income was distributed to any of the North Carolina beneficiaries. Plaintiff sought a refund of those taxes totaling more than $1.3 million, including $79,634.00 paid for 2005, $106,637.00 paid for 2006, $1,099,660.00 paid for 2007, and $17,241.00 paid for 2008. Defendant denied the refund request on 11 February 2011.

On 21 June 2012, plaintiff filed a complaint in Superior Court, Wake County, alleging that defendant wrongfully denied plaintiff's request for a refund because N.C.G.S. § 105-160.2 is both unconstitutional on its face and as applied to collect income taxes from plaintiff during those tax years. Plaintiff claimed that the taxes collected pursuant to section 105-160.2 violate the Due Process Clause because plaintiff did not have sufficient minimum contacts with the State of North Carolina. Plaintiff also claimed that the taxes violate the Commerce Clause on several grounds,

including that the tax was not applied to an activity with a substantial nexus to the taxing state. Plaintiff claimed that consequently, the tax also violated Article I, Section 19 of the state constitution. Based on these claims, plaintiff requested a declaration that section 105-160.2 is unconstitutional and an order from the court requiring defendant to refund any taxes, penalties, and interest paid by plaintiff for tax years 2005 through 2008, and enjoining defendant from enforcing any future assessments against plaintiff pursuant to section 105-160.2. Subsequent evidence indicated that penalties were assessed against plaintiff for tax years 2005 and 2006. These penalties were not paid by plaintiff and were ultimately waived at plaintiff's request, rendering moot that specific portion of plaintiff's claim for relief.

In accord with N.C.G.S. § 7A-45.4(b), this case was designated as a mandatory complex business case by the Chief Justice on 19 July 2012. On 11 February 2013, the Business Court issued an Opinion and Order on Defendant's Motion to Dismiss in which it granted the motion as to plaintiff's claim for injunctive relief, but denied the motion as to plaintiff's constitutional claims.

Relevant to this appeal, plaintiff filed a motion for summary judgment on its constitutional claims on 8 July 2014, and defendant filed its own motion for summary judgment on 4 September 2014. In its Opinion and Order on Motions for Summary Judgment, the Business Court observed that when a taxed entity such as plaintiff is not physically present in the taxing state, the taxed entity must "purposefully avail[ ] itself of the benefits of an economic market in the forum state" for the tax to satisfy

due process requirements. *Kimberley Rice Kaestner 1992 Family Trust v. N.C. Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607, at *4 (N.C. Super. Ct. Wake County (Bus. Ct.) Apr. 23, 2015), *aff'd*, ___, N.C. App. ___, 789 S.E.2d 645 (2016) (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 307, 112 S. Ct. 1904, 1910 (1992)). Determining that plaintiff did not purposefully avail itself of the benefits of the taxing state based solely on the beneficiaries' residence in North Carolina, the Business Court concluded that the provision of section 105-160.2 allowing taxation of trust income "that is for the benefit of a resident of this State," N.C.G.S. § 105-160.2 (2005), violated both the Due Process Clause and Article I, Section 19 of the state constitution as applied to plaintiff. Applying the four-pronged analysis for determining the constitutionality of a tax pursuant to the Commerce Clause as set forth by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079 (1977), the Business Court also determined that the same provision of section 105-160.2 violated the Commerce Clause as applied to plaintiff. Therefore, the Business Court denied defendant's motion for summary judgment, granted plaintiff's motion for summary judgment, and ordered that any taxes and penalties paid by plaintiff pursuant to section 105-160.2 be refunded with interest.

Defendant noticed its appeal to the Court of Appeals on 22 May 2015. Before that court, defendant challenged the substantive conclusions of the Business Court that taxation of the trust based solely on the residency of the beneficiaries violated both the Due Process and Commerce Clauses as applied to plaintiff. *Kaestner 1992*

Family Tr. v. N.C. Dep't of Revenue, ___ N.C. App. ___, ___, 789 S.E.2d 645, 647-48 (2016). Like the Business Court, the Court of Appeals also reasoned from the United States Supreme Court's guidance that "[t]he Due Process Clause requires [(1)] some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and [(2)] that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Id.* at ___, 789 S.E.2d at 649 (second and third alterations in original) (quoting *Quill*, 504 U.S. at 306, 112 S. Ct. at 1909-10 (citations and internal quotation marks omitted)). Noting that a trust has a separate legal existence for the purpose of income taxes pursuant to *Anderson v. Wilson*, 289 U.S. 20, 27, 53 S. Ct. 417, 420 (1933), *Kaestner 1992 Family Tr.*, ___ N.C. App. at ___, 789 S.E.2d at 650, the Court of Appeals held that the connection between North Carolina and the trust based solely on the residence of the beneficiaries was insufficient to satisfy due process requirements, *id.* at ___, 789 S.E.2d at 651. Consequently, the Court of Appeals affirmed the Business Court's order granting summary judgment for plaintiff. *Id.* at ___, 789 S.E.2d at 651. The Court of Appeals chose not to address whether taxation of plaintiff also violated the Commerce Clause. *Id.* at ___, 789 S.E.2d at 651.

On appeal to this Court from the decision of the Court of Appeals, defendant continues to argue that plaintiff had minimum contacts with the State of North Carolina sufficient to satisfy due process based on the presence of the beneficiaries in the state. Defendant also argues that plaintiff had sufficient minimum contacts with

North Carolina through certain acts of the trustee whereby plaintiff benefitted from "the ordered society maintained by taxation in North Carolina." We disagree.

"Our standard of review of an appeal from summary judgment is de novo." *In re Will of Jones*, 362 N.C. 569, 573, 669 S.E.2d 572, 576 (2008) (citing *Forbis v. Neal*, 361 N.C. 519, 523-24, 649 S.E.2d 382, 385 (2007)). "Under the *de novo* standard of review, the [Court] 'consider[s] the matter anew[ ] and freely [substitutes] its own judgment for' [that of the lower court]." *Midrex Techs., Inc. v. N.C. Dep't of Revenue*, 369 N.C. 250, 257, 794 S.E.2d 785, 791 (2016) (first and fifth alterations in original) (quoting *N.C. Dep't of Env't & Nat. Res. v. Carroll*, 358 N.C. 649, 660, 599 S.E.2d 888, 895 (2004) (second and third alterations in original)). On a motion for summary judgment, "[t]he judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." N.C.G.S. § 1A-1, Rule 56(c) (2017).

The relevant provision of section 105-160.2 has remained substantively unchanged since the tax years at issue and states that income tax on an estate or trust "is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State." *Id.* § 105-160.2 (2017). In its complaint and motion for summary judgment, plaintiff maintained that this section is both unconstitutional on its face and as applied to plaintiff. We presume "that any act

passed by the legislature is constitutional, and [we] will not strike it down if [it] can be upheld on any reasonable ground." *State v. Bryant*, 359 N.C. 554, 564, 614 S.E.2d 479, 486 (2005) (quoting *State v. Thompson*, 349 N.C. 483, 491, 508 S.E.2d 277, 281-82 (1998) (second alteration in original)). Consequently, "[a]n individual challenging the facial constitutionality of a legislative act 'must establish that no set of circumstances exists under which the [a]ct would be valid.' " *Thompson*, 349 N.C. at 491, 508 S.E.2d at 282 (second alteration in original) (quoting *United States v. Salerno*, 481 U.S. 739, 745, 107 S. Ct. 2095, 2100 (1987)). Given this exacting standard and that the allegations and evidence appear relevant solely to whether defendant unconstitutionally collected income taxes from plaintiff for tax years 2005 through 2008, we consider only whether section 105-160.2 is unconstitutional as applied to plaintiff to collect the taxes at issue.

In considering an as-applied challenge to the constitutionality of a statute, we look to whether the statute is constitutional in the limited context of the facts of the case before us. Then, as with any constitutional challenge, "[i]f there is a conflict between a statute and the Constitution, this Court must determine the rights and liabilities or duties of the litigants before it in accordance with the Constitution, because the Constitution is the superior rule of law in that situation." *Adams v. N.C. Dep't of Nat. & Econ. Res.*, 295 N.C. 683, 690, 249 S.E.2d 402, 406 (1978) (quoting *Nicholson v. State Educ. Assistance Auth.*, 275 N.C. 439, 447, 168 S.E.2d 401, 406 (1969)).

The Fourteenth Amendment directs that no State shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend XIV. Similarly, our state constitution declares that "[n]o person shall be . . . in any manner deprived of his life, liberty, or property, but by the law of the land." N.C. Const. art. I, § 19. Indeed, we have determined that "[t]he term 'law of the land' as used in Article I, Section 19, of the Constitution of North Carolina, is synonymous with 'due process of law' as used in the Fourteenth Amendment to the Federal Constitution." *Rhyne v. K-Mart Corp.*, 358 N.C. 160, 180, 594 S.E.2d 1, 15 (2004) (quoting *In re Moore*, 289 N.C. 95, 98, 221 S.E.2d 307, 309 (1976)). Accordingly, our analysis of plaintiff's due process challenge below also applies to plaintiff's state constitutional claim.

When applied to taxation, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' " *Quill*, 504 U.S. at 306, 112 S. Ct. at 1909 (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 539 (1954)). Due process also requires that "the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State,' " *id.* at 306, 112 S. Ct. at 1909-10 (internal quotation marks omitted) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273, 98 S. Ct. 2340, 2344 (1978)); however, in this case we are concerned only with the first requirement. This "minimum connection," which is more commonly referred to as "minimum contacts," *see id.* at 307, 112 S. Ct. at 1910 (citing *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316, 66 S. Ct. 154, 158 (1945)), exists when

the taxed entity "purposefully avails itself of the benefits of an economic market" in the taxing state "even if it has no physical presence in the State," *id.* at 307, 112 S. Ct. at 1910 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476, 105 S. Ct. 2174, 2184 (1985)). The Court in *Quill Corporation* therefore declared: "[T]o the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State" for imposition and collection of a tax, "we overrule those holdings as superseded by developments in the law of due process." *Id.* at 308, 112 S. Ct. at 1911. Applying that standard, the Court went on to hold that the plaintiff in *Quill Corporation* "purposefully directed its activities at North Dakota residents, that the magnitude of those contacts [was] more than sufficient for due process purposes, and that the use tax [was] related to the benefits Quill receive[d] from access to the State," *id.* at 308, 112 S. Ct. at 1911, when the plaintiff generated revenue of almost $1 million annually from selling office equipment and supplies to approximately 3,000 customers in North Dakota even though all merchandise was delivered from out of state by mail or common carriers, *id.* at 302, 112 S. Ct. at 1907-08.

We have similarly determined that a finding of minimum contacts sufficient to satisfy due process "will vary with the quality and nature of the [party's] activity, but it is essential in each case that there be some act by which the [party] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Skinner v. Preferred Credit*, 361 N.C. 114, 123, 638 S.E.2d 203, 210-11 (2006) (quoting *Chadbourn, Inc. v. Katz*, 285

N.C. 700, 705, 208 S.E.2d 676, 679 (1974)). In light of *Quill Corporation* and our understanding of minimum contacts analysis, we therefore consider defendant's first argument in terms of whether plaintiff can be said to have minimum contacts with North Carolina based on the presence of its beneficiaries in our State.

The Supreme Court has observed that even though a "trust is an abstraction . . . . the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions." *Anderson*, 289 U.S. at 27, 53 S. Ct. at 420. The Internal Revenue Code imposes a separate tax on the income of trusts, *see* 26 U.S.C. § 1(e) (2012), implicitly recognizing, at least for tax purposes, that a trust is a separate entity to which income is separately attributed. Any tax on that income is physically paid by the fiduciary or trustee, with the amount of the tax being "computed in the same manner as in the case of an individual." *Id.* § 641(a)-(b). In North Carolina "[t]he taxable income of an estate or trust is the same as taxable income for such an estate or trust under the provisions of the Code." N.C.G.S. § 105-160.2. Neither the Code nor Chapter 105 conflates the income of the trust with the income of a beneficiary.

In *Brooke v. City of Norfolk* the Supreme Court considered whether the City of Norfolk and Commonwealth of Virginia had violated the Due Process Clause by taxing the body of a Maryland trust when none of the property held by the trust had ever been present in Virginia. 277 U.S. 27, 28, 48 S. Ct. 422, 422 (1928). Although

the Supreme Court applied presence-focused due process analysis that has since been supplanted by the minimum contacts test, *see Quill*, 504 U.S. at 308, 112 S. Ct. at 1911, the Court also recognized that a trust and its beneficiary are legally independent entities when it observed that the property held by the trust "is not within the State, does not belong to the [beneficiary] and is not within her possession or control. The assessment is a bare proposition to make the [beneficiary] pay upon an interest to which she is a stranger," *Brooke*, 277 U.S. at 29, 48 S. Ct. at 422.

That plaintiff and its North Carolina beneficiaries have legally separate, taxable existences is critical to the outcome here because a taxed entity's minimum contacts with the taxing state cannot be established by a third party's minimum contacts with the taxing state. *See Walden v. Fiore*, ___ U.S. ___, ___, 134 S. Ct. 1115, 1122 (2014) (stating that "unilateral activity of another party or a third person is not an appropriate consideration when determining whether a defendant has sufficient contacts with a forum State" (quoting *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 417, 104 S. Ct. 1868, 1873 (1984))); *Hanson v. Denckla*, 357 U.S. 235, 253, 78 S. Ct. 1228, 1239-40 (1958) ("The unilateral activity of those who claim some relationship with a nonresident [party] cannot satisfy the requirement of contact with the forum State."). Here it was plaintiff's beneficiaries, not plaintiff, who reaped the benefits and protections of North Carolina's laws by residing here. Because plaintiff and plaintiff's beneficiaries are separate legal entities, due process was not satisfied solely from the beneficiaries' contacts with North Carolina.

Defendant challenges this conclusion by citing to two decisions in which foreign jurisdictions allegedly reached the opposite result. The Supreme Court of Connecticut held that taxation of an *inter vivos* trust did not violate due process because the beneficiary of the trust was a Connecticut domiciliary. *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 204, 733 A.2d 782, 802, *cert. denied*, 528 U.S. 965, 120 S. Ct. 401 (1999). Describing the domicile of the beneficiary as the "critical link," the Court in *Gavin* went on to reason that the beneficiary "enjoyed all of the protections and benefits afforded to other domiciliaries. Her right to the eventual receipt and enjoyment of the accumulated income was, and so long as she is such a domiciliary will continue to be, protected by the laws of the state." *Id.* at 204, 733 A.2d at 802. Therefore, the Court concluded in *Gavin*:

> [J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws; it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits.

Id. at 205, 733 A.2d at 802 (internal citation omitted). Defendant also cites to a decision of the Supreme Court of California for the similar proposition that a "beneficiary's state of residence may properly tax the trust on income which is payable in the future to the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of such accumulated income." *McCulloch v. Franchise Tax Bd.*, 61 Cal. 2d 186, 196, 390 P.2d 412, 419 (1964) (emphasis omitted).

We do not find either *Gavin* or *McCulloch* persuasive in deciding the present case. The Court in *Gavin* erroneously failed to consider that a trust has a legal existence apart from the beneficiary and that, consequently, for taxation to satisfy due process pursuant to *Quill*, the trust itself must have "some definite link, some minimum connection" with the taxing state by "purposefully avail[ing] itself of the benefits of an economic market" in that state. *Quill*, 504 U.S. at 306-07, 112 S. Ct. at 1909-10. Furthermore, both the Court in *Gavin* and defendant, in its arguments before this Court, misconstrue a trust's existence as "a fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person," *Wescott v. First & Citizens Nat'l Bank of Elizabeth City*, 227 N.C. 39, 42, 40 S.E.2d 461, 462-63 (1946) (quoting Restatement (First) of Trusts § 2 (Am. Law Inst. 1935)), to mean that any possible benefit received by the beneficiary may be imputed to the trust. That conclusion simply does not follow.

In contrast to *Gavin*, several other jurisdictions have applied reasoning similar to our analysis here in the context of deciding whether taxation of a given trust violated due process. *See Linn v. Dep't of Revenue*, 2013 IL App (4th) 121055, ¶ 33, 2 N.E.3d 1203, 1211 (2013) (applying *Quill* and holding that there was insufficient contact between Illinois and the taxed trust to satisfy due process when the trust, *inter alia*, "had nothing in and sought nothing from Illinois" and conducted all of its business in Texas), *appeal dismissed*, 387 Ill. Dec. 512, 22 N.E.3d 1165 (2014);

Fielding v. Comm'r of Revenue, File Nos. 8911–R, 8912–R, 8913–R, 8914–R, 2017 WL 2484593, at *19-20 (Minn. T.C. May 31, 2017) (deciding that taxation of an *inter vivos* trust based solely on the in-state domicile of the grantor at the time the trust became irrevocable violated due process); *Residuary Tr. A v. Director, Div. of Taxation*, 27 N.J. Tax 68, 72-73, 78 (2013) (holding that neither the New Jersey domicile of a deceased testator nor the New Jersey business interests of several corporations in which the testamentary trust held stock justified New Jersey's taxation of "undistributed income from sources outside New Jersey" pursuant to the due process minimum contacts standard), *aff'd per curiam*, 28 N.J. Tax 541 (2015); *T. Ryan Legg Irrevocable Tr. v. Testa*, 149 Ohio St. 3d 376, 2016-Ohio-8418, 75 N.E.3d 184, at ¶ 68 (2016) (applying *Quill* and holding that a tax assessment by Ohio against a Delaware trust did not violate due process when the trust was created by an Ohio resident to dispose of his interest in a corporation that "conducted business in significant part in Ohio" and the settlor's "Ohio contacts [were] still material for constitutional purposes"), *cert. denied*, ___ U.S. ___, 138 S. Ct. 222 (2017).

McCulloch, on the other hand, was decided before *Quill Corporation*, and therefore has a limited ability to inform our application of the Court's due process analysis in *Quill*. Moreover, we find *McCulloch* to be factually distinguished from the present case because the taxed entity in that case was both a beneficiary and a trustee of the trust and also resided in the taxing jurisdiction. Indeed, in holding that the taxes at issue did not violate due process, the Court in *McCulloch* particularly

relied on the fact that the trustee was a domiciliary of the taxing jurisdiction. *See McCulloch*, 61 Cal. 2d at 194, 390 P.2d at 418. However, that circumstance is not present in this case.

As an alternative to its argument that due process was satisfied based on the North Carolina residence of the beneficiaries, defendant also presents the theory that taxation satisfied due process here because plaintiff "reached out to North Carolina by purposefully taking on a long-term relationship with the trust's beneficiaries, even though the trustees . . . never entered the state." In support, defendant notes that Bernstein restructured the original trust for Kaestner's benefit, regularly communicated with her about management of plaintiff, and directed a loan to Kaestner from plaintiff's assets—all actions that, according to defendant, indicated that plaintiff would have a continuing relationship with Kaestner while she was in North Carolina.

This argument stems from misapprehension of both the facts and law relevant to this case. The undisputed evidence in the record shows that contact between Bernstein and Kaestner regarding administration of the trust was infrequent—consisting of only two meetings during the tax years in question, both of which occurred in New York. Any connection between plaintiff and North Carolina based on the loan is also irrelevant given that the loan was issued in January 2009, after the tax years at issue. Additionally, the United States Supreme Court has directed that " 'minimum contacts' analysis looks to the defendant's contacts with the forum

State itself, not the defendant's contacts with persons who reside there." *Walden*, ___ U.S. at ___, 134 S. Ct. at 1122 (citations omitted). As we have already stated, for due process purposes plaintiff, as a separate legal entity in the context of taxation, would have needed to purposefully avail *itself* of the benefits and protections offered by the State. *See Quill*, 504 U.S. at 306-07, 112 S. Ct. at 1909-10. Mere contact with a North Carolina beneficiary does not suffice.

For taxation of a foreign trust to satisfy the due process guarantee of the Fourteenth Amendment and the similar pledge in Article I, Section 19 of our state constitution, the trust must have some minimum contacts with the State of North Carolina such that the trust enjoys the benefits and protections of the State. When, as here, the income of a foreign trust is subject to taxation solely based on its beneficiaries' availing themselves of the benefits of our economy and the protections afforded by our laws, those guarantees are violated. Therefore, we hold that N.C.G.S. § 105-160.2 is unconstitutional as applied to collect income taxes from plaintiff for tax years 2005 through 2008. Accordingly, we affirm the decision of the Court of Appeals that affirmed the Business Court's order granting summary judgment for plaintiff and directed that defendant refund to plaintiff any taxes paid by plaintiff pursuant to section 105-160.2 for tax years 2005 through 2008.

AFFIRMED.

Justice ERVIN dissenting.

As the majority correctly indicates, the proper resolution of this case hinges upon the extent, if any, to which the taxpayer had sufficient minimum contacts with North Carolina to satisfy federal due process requirements. Although we are required to make what I believe to be a close call in this case, I feel compelled to conclude, after careful scrutiny of the record in light of the applicable relevant legal standard, that taxpayer "purposefully avail[ed] itself of the benefits of an economic market" in North Carolina despite having "no physical presence in the State." *Quill Corp. v. North Dakota*, 504 U.S. 298, 307, 112 S. Ct. 1904, 1910, 119 L. Ed. 2d 91, 102-03 (1992) (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476, 105 S. Ct. 2174, 2184, 85 L. Ed. 2d 528, 543 (1985)). As a result, I respectfully dissent from my colleagues' decision.

According to the undisputed facts contained in the record as identified by the trial court, Joseph Lee Rice, III, established the Rice Family 1992 Trust for the benefit of his children in 1992. The Family Trust was created in New York, with the trust instrument providing that the Family Trust was to be governed by New York law. In 2005, David Bernstein, a resident of Connecticut, was appointed trustee of the Family Trust and continued to act in that capacity throughout the time period at issue in this case. In 2006, Mr. Bernstein, physically divided the Family Trust into three trusts, one of which, plaintiff Kimberly Rice Kaestner 1992 Family Trust, was intended to benefit Kimberly Rice Kaestner and her three children, "all of whom were

residents and domiciliaries of North Carolina in the tax years at issue." Mr. Bernstein served as the trustee of the Kaestner Trust following the division of the Family Trust into its three constituent parts.

Throughout the entire interval from 2005 through 2008, which are the tax years at issue in this case, the documents related to the Kaestner Trust were kept in New York, while the custodian of the Kaestner Trust's assets was located in Boston, Massachusetts. No distributions were made to any beneficiary of the Kaestner Trust during the 2005 through 2008 tax years. During the period from 2005 through 2008, Mr. Bernstein communicated with Ms. Kaestner regarding the Kaestner Trust and provided her with accountings relating to the Kaestner Trust covering the periods from 22 December 2005 through 31 December 2006 and 23 June 2006 through 8 October 2009. In addition, Mr. Bernstein and the law firm with which he was affiliated provided Ms. Kaestner with legal advice regarding matters relating to the Kaestner Trust.

As the entire Court appears to agree, the resolution of this case hinges upon a proper understanding of the decision of the United States Supreme Court in *Quill*, which involved a Delaware corporation that sold office equipment and had physical offices and warehouses in Illinois, California, and Georgia. *Quill*, 504 U.S. at 302, 112 S. Ct. at 1907, 119 L. Ed. at 100. Quill solicited business by using catalogs, flyers, and telephone calls and placing advertisements in national periodicals. *Id.* at 302, 112 S. Ct. at 1907, 119 L. Ed. at 100. As a result of its business activities, Quill had

about 3,000 customers and made $1 million in sales in North Dakota during the relevant period. *Id.* at 302, 112 S. Ct. at 1908, 119 L. Ed. at 100. A North Dakota statute provided that retailers, including mail-order companies, were subject to a use tax "even if they maintain no property or personnel in North Dakota." *Id.* at 303, 112 S. Ct. at 1908, 119 L. Ed. at 100. The State argued that, despite Quill's lack of a physical presence within North Dakota, the State "had created 'an economic climate that fosters demand for' Quill's products, maintained a legal infrastructure that protected that market, and disposed of 24 tons of catalogs and flyers mailed by Quill into the State every year." *Id.* at 304, 112 S. Ct. at 1908-09, 119 L. Ed. at 101.

According to the United States Supreme Court, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax' and that the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State.' "[1] *Id.* at 306, 112 S. Ct. at 1909-10, 119 L. Ed. 2d at 102 (first quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 539, 98 L. Ed. 744 (1954); then quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197 (1978)). As the United States Supreme Court noted, it has "abandoned more formalistic tests that focused on [an entity's] 'presence' within a State in favor of a more flexible inquiry into . . . [an entity's] contacts with the forum." *Id.* at 307,

[1] The extent to which the second prong of the due process analysis has been satisfied does not appear to be before us in this case at this time.

112 S. Ct. at 1910, 119 L. Ed. 2d at 102 (citing, *inter alia*, *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 66 S. Ct. 154, 90 L. Ed. 95 (1945)). "Applying these principles, we have held that if a foreign [entity] purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's" collection of taxes "even if it has no physical presence in the State." *Id*. at 307, 112 S. Ct. at 1910, 119 L. Ed. 2d at 103 (citing *Burger King Corp.*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528). As a result, given that Quill had "purposefully directed its activities at North Dakota residents," its contacts with North Dakota were "more than sufficient for due process purposes." *Id*. at 308, 112 S. Ct. at 1911, 119 L. Ed. 2d at 104.

The parties have spent considerable time and effort debating the extent, if any, to which the fact that the beneficiaries of the Kaestner Trust resided in North Carolina during the relevant tax years has any bearing on the required due process analysis. In reaching the conclusion that the residence of the beneficiaries has no bearing upon the proper resolution of this case, my colleagues have deemed *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 782, *cert. denied*, 528 U.S. 965, 120 S. Ct. 401, 145 L. Ed. 2d 312 (1999), and *McCulloch v. Franchise Tax Board*, 61 Cal. 2d 186, 390 P.2d 412 (1964), to be essentially irrelevant. I am not inclined to completely disregard either of those decisions, which, to the best of my knowledge, appear to be the only cases decided by state courts of last resort to address the question that is before us in this case, while recognizing that there are distinguishing

features which may serve to render them somewhat less persuasive than they might otherwise be.

Admittedly, the assertion of taxing authority over the inter vivos trust at issue in *Gavin* arose from a situation in which "the settlor of the trust was a Connecticut domiciliary when the trust was established and the beneficiary is a Connecticut domiciliary." *Gavin*, 249 Conn. at 183, 733 A.2d at 790. However, in upholding the taxability of the undistributed income held in an inter vivos trust, the Connecticut Supreme Court specifically stated that, "just as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws," "it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits." *Id.* at 205, 733 A.2d at 802. As a result, the Connecticut Supreme Court's decision with respect to the taxability of the undistributed income held in the inter vivos trust appears to me to hinge upon the residence of the beneficiary rather than the fact that the settlor had been a resident of Connecticut at the time that the inter vivos trust had been created.

I am loath to completely disregard *McCulloch* for similar reasons. Although the beneficiary of the trust at issue in *McCulloch* also served as one of the trustees, the California Supreme Court's analysis in that case clearly relies upon the status of the person in question as a beneficiary rather than upon his status as a trustee, with this fact being evidenced by the California Supreme Court's statement that "the

beneficiary's state of residence may properly tax the trust on income which is payable in the future to the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of such accumulated income." *McCulloch*, 61 Cal. 2d at 196, 390 P.2d at 419 (emphasis omitted). Similarly, while *McCulloch* antedates *Quill* and *Burger King*, the logic utilized by the California Supreme Court appears to me to rest upon the same considerations that underlie the United States Supreme Court's modern due process jurisprudence. For example, the California Supreme Court states that "[t]he tax imposed by California upon the beneficiary is constitutionally supported by a sufficient connection with, and protection afforded to, plaintiff as such beneficiary." *Id*. at 196, 390 P.2d at 419. As a result, I am unable to agree with my colleagues' determination that neither *Gavin* nor *McCulloch* has any bearing upon the proper resolution of this case and am inclined to be persuaded by their logic to believe that, while not dispositive, the presence of the beneficiaries of the Kaestner Trust in North Carolina has some bearing on the proper performance of the required due process analysis.

I also cannot concur in the argument adopted by the Court of Appeals to the effect that the United States Supreme Court has already made our decision for us in *Brooke v. City of Norfolk*, 277 U.S. 27, 48 S. Ct. 422, 72 L. Ed. 767 (1928). Although *Brooke* has not been overruled, it antedates *Quill* and *Burger King* and rests upon the sort of formalistic, presence-focused approach that the United States Supreme

Court rejected in those cases in favor of a less rigid "minimum connections" approach. *See Quill*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91; *Burger King*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528. In addition, *Brooke* involved an attempt by one state to tax a trust corpus held in another state, which is a very different undertaking than an attempt to tax the undistributed income of a non-North Carolina trust that is held for the benefit of a North Carolina resident.[2] The same logic renders the Kaestner Trust's reliance upon the decision of the United States Supreme Court in *Safe Deposit & Trust Co. of Baltimore v. Commonwealth of Virginia*, 280 U.S. 83, 50 S. Ct. 59, 74 L. Ed. 180 (1929), which involved an attempt to tax the corpus, rather than the undistributed income, of a non-jurisdictional trust based upon the existence of a resident beneficiary that the Court rejected on the basis of a pre-*Quill* method of analysis, unpersuasive. As a result, neither of these cases supports, much less compels, a decision in the Kaestner Trust's favor. Instead, my review of the decisions cited by both parties compels me to conclude that the only way to properly resolve this case involves reliance upon a very fact-specific analysis of the extent, if any, to which the Kaestner Trust "purposefully avail[ed] itself of the benefits of an economic market in the forum State," *see Quill*, 504 U.S. at 307, 112 S. Ct. at 1910, 119 L. Ed.

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[2] Admittedly, this Court has not adopted the Court of Appeals' treatment of *Brooke* as dispositive in its opinion. Instead, the Court simply cites *Brooke* for the unexceptionable proposition that "a trust and its beneficiary are legally independent entities." For the reasons set forth in the text of this dissenting opinion, I believe that a proper due process analysis focused upon the activities of the Kaestner Trust in light of Ms. Kaestner's residence suffices to establish sufficient "minimum contacts" to support the Department of Revenue's attempt to tax the undistributed income applicable to Ms. Kaestner.

2d at 103, with this analysis deeming the presence of the beneficiary in North Carolina to be relevant, but not dispositive.

As the Supreme Court explained in *Burger King*,

> it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contact can defeat personal jurisdiction there.

471 U.S. at 476, 105 S. Ct. at 2184, 85 L. Ed. 2d at 544 (citations omitted). Although the assets contained in the Kaestner Trust were held in Boston, and the relevant documents were held in New York and although the trustee worked in New York and resided in Connecticut during the tax years at issue in this case, "business [was] transacted . . . by mail and wire communications across state lines," including those of North Carolina. *See id*. at 476, 105 S. Ct. at 2184, 85 L. Ed. 2d at 544. Among other things, Ms. Kaestner was known to be a resident of North Carolina at the time that the Kaestner Trust was created for her benefit. In addition, the trustee transmitted information to Ms. Kaestner, provided advice to Ms. Kaestner, and communicated with Ms. Kaestner in other ways with full knowledge of the fact that she resided in North Carolina. The Kaestner Trust could not have successfully carried out these functions in the absence of the benefits that North Carolina provided to Ms. Kaestner during the time that she lived here. As a result, I am unable

to conclude, given the applicable standard of review, that the Kaestner Trust lacked sufficient contacts with North Carolina to permit the State to tax the undistributed income held by the Kaestner Trust for Ms. Kaestner's benefit. Therefore, I see no due process violation. As a result, for all of these reasons, I respectfully dissent from my colleagues' decision to affirm the Court of Appeals' decision.

No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

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QUESTION PRESENTED

Does the Due Process Clause prohibit states from taxing trusts based on trust beneficiaries' in-state residency?

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INTRODUCTION

Kimberley Rice Kaestner is the beneficiary of a trust that her father created to transfer his wealth. During the tax years at issue in this case, Ms. Kaestner's trust generated millions of dollars of income. If the trust prevails here, however, it will avoid state income taxes on nearly all of that income.

That outcome is possible only because of a mistaken interpretation of the Due Process Clause. The North Carolina Supreme Court held here that when a trust's beneficiary lives in a state, that residency does not establish the connection with the state that due process requires.

That interpretation of the Due Process Clause results in a judicially created tax shelter.

Here, Ms. Kaestner's family skillfully exploited this tax shelter. The trust at issue had a trustee from Connecticut, a state that does not tax trusts under the circumstances here. Thus, the trust paid no income taxes in Connecticut.

In North Carolina, where Ms. Kaestner and her children lived, the trust did face state taxes, but it challenged the state's trust-tax statute on due-process grounds. The trust argued that North Carolina—the state where Ms. Kaestner lived, raised a family, and attended a state-funded university—lacked a "minimum connection" to her trust.

The North Carolina Supreme Court accepted the trust's arguments. It reasoned that Ms. Kaestner is a

mere "third party" to the trust that bears her name. On that theory, the court held that Ms. Kaestner's extensive North Carolina contacts did not count for due-process purposes. After concluding that the Kaestner Trust was not physically present in North Carolina, the court held that the Due Process Clause barred North Carolina from taxing the trust's income.

This *Pennoyer*-like formalism has no place in modern due-process doctrine. *See Pennoyer v. Neff*, 95 U.S. 714, 733–34 (1878). This Court's modern teachings on due process elevate fairness over formalism.

Under a fairness-based analysis, as well as settled principles of trust law, a beneficiary is the central figure in a trust. Serving the beneficiary's interests is the trust's reason for being. For these reasons, when a trust beneficiary lives in a state and benefits from the state's services, her trust has the required connection with that state.

Upholding taxes on that basis follows not only from modern due-process analysis, but also from federalism. This Court has long recognized the importance of the states' authority to tax. The due-process rule that the state supreme court adopted here, however, lays waste to the states' taxing authority. That rule invalidates a taxing approach that North Carolina has followed for almost a century.

The state supreme court's holding, moreover, creates a tax shelter that few large trusts will be able to resist. To avoid state income taxes under that holding, all one needs to do is select a trustee in a state

with no trust-income tax. Trusts in this country earn about 120 billion dollars of income every year. With that much income at stake, constitutionalizing a tax shelter would deal a serious blow to the fiscal health of many states.

Nothing in the Due Process Clause requires such a result. Under this Court's teachings, due process does not bar the states from taxing trusts based on a trust beneficiary's residency.

Because the state supreme court reached the opposite conclusion, its decision should be reversed. The tax shelter here deserves the same fate that befell a similar judicially created tax shelter last Term. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2094 (2018).

OPINIONS BELOW

The opinion of the Supreme Court of North Carolina (Pet. App. 1a–26a) is reported at 814 S.E.2d 43 (N.C. 2018).

The opinion of the North Carolina Court of Appeals (Pet. App. 27a–40a) is reported at 789 S.E.2d 645 (N.C. Ct. App. 2016).

The state trial court's decision (Pet. App. 41a–69a) is available on Westlaw. *See Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015).

JURISDICTION

The judgment below, affirming a final judgment on constitutional grounds, was entered on June 8, 2018. Pet. App. 1a. The petition for certiorari was filed on October 9, 2018, and granted on January 11, 2019. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fourteenth Amendment provides that "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1.

The North Carolina tax statute at issue states, in relevant part:

> The tax imposed by this Part applies to the taxable income of estates and trusts as determined under the provisions of the [United States Internal Revenue] Code except as otherwise provided in this Part. The taxable income of an estate or trust is the same as taxable income for such an estate or trust under the provisions of the [Internal Revenue] Code, [subject to certain adjustments]. The tax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to

> the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State. . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.

N.C. Gen. Stat. § 105-160.2 (2017).

STATEMENT

I. Background

Eleven states tax trusts, in whole or in part, based on trust beneficiaries' in-state residency.[1]

Before this lawsuit, North Carolina's trust-tax statute (or one of its predecessors) had been in force and unchallenged since 1923.[2] The statute taxes "the amount of the taxable income of [a] . . . trust that is for the benefit of a resident of" North Carolina. N.C. Gen. Stat. § 105-160.2 (2017).

II. The trusts at issue

In 1992, Joseph Lee Rice, III, created the Rice Family Trust to transfer wealth to his descendants. Pet. App. 2a. Mr. Rice referred to this trust as a "family asset." App. 51. He named his three children, including his daughter, Kimberley Rice Kaestner, as the trust's beneficiaries. Pet. App. 2a–3a.

Mr. Rice appointed William B. Matteson, a lawyer, as the Rice Family Trust's trustee. *See* Pet. App. 2a. Mr. Rice directed Mr. Matteson to distribute the trust's

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[1] Those states (besides North Carolina) are Alabama, *see* Ala. Code § 40-18-1(33); California, *see* Cal. Rev. & Tax. Code § 17742(a); Connecticut, *see* Conn. Gen. Stat. § 12-701(a)(4); Georgia, *see* Ga. Code Ann. § 48-7-22(a)(1)(A); Missouri, *see* Mo. Rev. Stat. § 143.331(1)(b); Montana, *see* Mont. Admin. R. 42.30.101(16); North Dakota, *see* N.D. Admin. Code 81-03-02.1-04; Ohio, *see* Ohio Rev. Code Ann. § 5747.01; Rhode Island, *see* 44 R.I. Gen. Laws § 44-30-5(c); and Tennessee, *see* Tenn. Code Ann. § 67-2-110(a).

[2] *See* Act of Mar. 3, 1923, ch. 4, § 205, 1923 N.C. Sess. Laws 67, 128.

assets "liberal[ly]" to "meet the needs of [the trust's] [b]eneficiaries." App. 51.

In 1997, Ms. Kaestner moved to North Carolina, where she and her husband raised a family. *See* Pet. App. 2a–3a.

In 2002, while Ms. Kaestner was living in North Carolina, the Rice Family Trust was divided informally into three separate shares. One of these three shares was for the benefit of Ms. Kaestner and her children. Pet. App. 3a.

In 2005, Mr. Matteson stepped down as the trustee of the Rice Family Trust. He was succeeded by David Bernstein, a lawyer at Debevoise & Plimpton LLP, the law firm that represents the Rice and Kaestner families. *See* Pet. App. 2a–3a; App. 41, 93.

Mr. Bernstein, by his own description, is "not a trust and estate lawyer." App. 92. Even so, he has another attribute that makes him a useful trustee: He is a resident of Connecticut, Pet. App. 2a, a state that does not tax trust income based on a trustee's residency alone.[3]

Soon after Mr. Bernstein became the trustee of the Rice Family Trust, he used Ms. Kaestner's share of that trust to form a new trust: the Kimberley Rice Kaestner 1992 Family Trust, the respondent in this case. Pet. App. 3a. The Kaestner Trust was established

[3] *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

for the benefit of North Carolinians: Ms. Kaestner and her children. *See* Pet. App. 3a.[4]

The trust instrument names Ms. Kaestner and her children as the Trust's beneficiaries. Pet. App. 44a.[5] Throughout the tax years at issue, 2005 to 2008, these beneficiaries lived in North Carolina. Pet. App. 3a.

During the tax years at issue, Mr. Bernstein administered the Trust to satisfy Ms. Kaestner's needs. He and Ms. Kaestner communicated by phone, by e-mail, by mail, and in person. *See* App. 106; N.C. R. pp. 177, 217. At times, Mr. Bernstein and Ms. Kaestner would have "a number of calls in a couple weeks." N.C. R. p. 177.

On at least two occasions, Mr. Bernstein met with Ms. Kaestner in New York to discuss trust business. They discussed, among other topics, whether Ms. Kaestner wanted to receive distributions of her trust's income. Pet. App. 4a; App. 106.

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[4] From this point on, this brief uses the terms "the Trust" and "the Kaestner Trust" to refer to the Kimberley Rice Kaestner 1992 Family Trust. As far as the Department is aware, and as far as the record here shows, the same trust instrument that formed the Rice Family Trust also governs the Kaestner Trust. App. 44–75.

[5] The Trust has referred to Ms. Kaestner as its "sole primary beneficiary." Plaintiff-Appellee's Brief at 2, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018) (No. 307PA15-2). In references to the facts here, this brief uses the term "the beneficiary" to refer to Ms. Kaestner, unless the context requires a more specific reference.

Ms. Kaestner also received accountings in North Carolina on the financial status of her trust. *See* Pet. App. 4a.

During the tax years at issue, the assets of the Kaestner Trust totaled about thirteen million dollars. App. 118. Mr. Bernstein, however, did not make any distributions of trust income or trust principal during those years. Pet. App. 3a. Instead, the Trust accumulated income for Ms. Kaestner's benefit. *See* Pet. App. 3a–4a.

At some point between late 2008 and January 2009, Ms. Kaestner asked Mr. Bernstein for a loan from the Trust's assets, so she could pursue a commodities investment. *See* Pet. App. 3a; App. 99–100, 113. She received a loan of $250,000 from the Trust's assets in January 2009, the first month after the tax years at issue. Pet. App. 3a. Ms. Kaestner was a North Carolinian then as well. The Trust made the loan at the lowest interest rate that the IRS allows without imposing a gift tax. *See* Pet. App. 46a–47a.

In June 2009, Ms. Kaestner turned 40. Pet. App. 3a. The trust instrument provided that when Ms. Kaestner turned 40, the Trust would terminate and its assets would be distributed to her. Pet. App. 3a. Before Ms. Kaestner turned 40, however, she talked with her father and Mr. Bernstein about whether she should receive this distribution. Pet. App. 3a–4a. Ms. Kaestner ultimately decided that she would rather wait for the distribution. Pet. App. 3a–4a.

Following Ms. Kaestner's wishes, Mr. Bernstein did not distribute the assets of the Trust to Ms. Kaestner in 2009. Instead, he "decanted" most of those assets into yet another trust that was created for her benefit.[6] Pet. App. 4a.

III. The taxes on the Kaestner Trust

Over the tax years at issue, the Kaestner Trust and its predecessor trust sought to avoid state income taxes in every state that might have imposed such a tax.

The Rice Family Trust used Mr. Matteson as its first trustee. In 1995, Mr. Matteson moved to Florida. App. 11. Florida has no income tax, so the Rice Family Trust avoided all state income taxation there.

In 2005, the Florida trustee was replaced with Mr. Bernstein, a Connecticut resident. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone. *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i). By having Mr. Bernstein serve as trustee, the Rice Family Trust and the Kaestner Trust avoided state income taxes in Connecticut.

They avoided most state income taxes in New York as well. After Mr. Bernstein became the trustee, he filed an amended trust-tax return for the Rice Family

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[6] Decanting a trust means distributing "some or all of a trust's assets to another trust." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 567, at 138 (Supp. 2018).

Trust in New York for 2005. That amended return invoked the Due Process Clause, stating that since Mr. Matteson's move to Florida in 1995, the Rice Family Trust "ha[d] been administered solely by a trustee domiciled outside the State of New York." App. 76. Mr. Bernstein went on to argue that the Rice Family Trust's "only contacts with [New York] in 2005 were the domicile of its [grantor] at the time the trust was created many years earlier and a negligible amount of income from intangible assets" in New York. App. 78.

Those due-process arguments relieved the Rice Family Trust from paying taxes on all of its income except $2,165 from New York sources. *See* App. 76–79. The trust's total income in 2005 was about $2,350,000. *See* App. 76–79. On virtually all of that income, the trust, by having Florida and Connecticut trustees, paid no state income taxes in New York.

In North Carolina, the Kaestner Trust sought to avoid state income taxes as well. Those efforts led to this lawsuit.

From 2005 through 2008, as noted above, the beneficiaries of the Kaestner Trust—Ms. Kaestner and her three children—were North Carolina residents. Pet. App. 3a–4a. The Trust earned millions of dollars of income during those years. Under North Carolina's trust-tax statute, that income generated a tax liability of about $1,280,000. The Trust paid these taxes under protest, then sued for a refund.

When the Trust sued North Carolina, it did not deny New York residency, as it had done in New York. Instead, in its North Carolina complaint, the Trust alleged that it was "a trust with a situs in New York." App. 9.

IV. The proceedings below

The Kaestner Trust brought this lawsuit as a constitutional challenge in state court.[7] Among its claims, the Trust asserted an as-applied challenge under the Due Process Clause of the Fourteenth Amendment. Pet. App. 4a–5a. In support of that challenge, the Trust alleged that it lacked a constitutionally sufficient connection with North Carolina. Pet. App. 4a–5a.

The state trial court concluded that North Carolina's assessment of taxes on the Trust violated the Due Process Clause.[8] Accordingly, the court ordered a refund of the taxes at issue. Pet. App. 69a.

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[7] The Tax Injunction Act, 28 U.S.C. § 1341 (2012), required Ms. Kaestner's Trust to file this lawsuit in state court. The Act provides that federal courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." *Ibid.*

[8] The Trust also pursued a Commerce Clause claim. The state trial court ruled in the trust's favor on that ground as well, holding that the court's due-process reasoning also showed a violation of the dormant Commerce Clause. Pet. App. 68a–69a. Neither of the state appellate courts addressed that part of the trial court's decision. *See* Pet. App. 7a–8a, 40a.

The North Carolina Court of Appeals affirmed. Pet. App. 27a.

In a 6-1 decision, the North Carolina Supreme Court affirmed the decision of the court of appeals. Pet. App. 2a. Applying the Due Process Clause, the court held that the in-state residency of trust beneficiaries is not a constitutionally sufficient connection with a state.

The court started its analysis by reasoning that a trust is an entity separate from its beneficiaries—in other words, that beneficiaries are third parties to a trust. Pet. App. 13a. Next, the court observed that third parties' contacts with a forum state do not count for due-process purposes. Pet. App. 13a. Finally, the court merged those two points and concluded that the North Carolina residency of the Kaestner Trust's beneficiaries does not establish any connection between the Trust and North Carolina. On that basis, the court held that North Carolina's trust-tax statute was unconstitutional as applied to the Trust. Pet. App. 18a.

Justice Sam J. Ervin, IV, dissented. In his opinion, he criticized the majority's "formalistic, presence-focused" analysis of due process. Pet. App. 24a. He opined that this Court's due-process decisions require a wider-ranging analysis of the Trust's connection with North Carolina—an analysis that gives weight to the in-state residency of the Trust's beneficiaries. Pet. App. 24a. Applying that analysis, Justice Ervin concluded that the Trust had a constitutionally sufficient

connection with North Carolina—a connection that brought the Trust within North Carolina's jurisdiction to tax. Pet. App. 24a.

SUMMARY OF ARGUMENT

The Due Process Clause does not bar a state from taxing a trust whose beneficiaries live in that state. Prohibiting those taxes, as the state supreme court did here, would harm the states in ways that the Due Process Clause does not compel.

To establish a due-process violation here, the Trust has the burden of satisfying two elements.

- First, the Trust must show that North Carolina lacks a "minimum connection" with "the person, property or transaction it seeks to tax." *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954)).
- Second, the Trust must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.' " *Quill*, 504 U.S. at 306 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).

Here, the Kaestner Trust cannot satisfy either of these elements.

First, Ms. Kaestner's residency in North Carolina establishes the required connection with the state.

The "minimum connection" standard centers on fairness, not formalism. *See infra* pp. 20–22. Indeed, this Court has specifically warned against using

"formalistic tests" to assess jurisdiction to tax. *Quill*, 504 U.S. at 30.

Under a fairness-based analysis, a trust has the required connection with a taxing state when a trust beneficiary lives in that state. A trust, after all, is not a distinct entity like a corporation. Instead, it is just an abstraction that describes a fiduciary relationship between people. *See Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016).

Because a trust has no entity status, the state supreme court erred by demanding connections between the Kaestner Trust "itself" and North Carolina. Pet. App. 18a. For purposes of due-process connections with the states, a trust has no "self."

Instead, the only way a trust can make contact with a state is through the trust's constituents—the grantor, the trustee, and the beneficiary. That conclusion follows not only from trust law, but also from *Greenough v. Tax Assessors*, 331 U.S. 486 (1947), and *Americold*, 136 S. Ct. 1012. *See infra* pp. 25–28.

Out of the three constituents in a trust, trust beneficiaries have the most important jurisdictional contacts. Under trust law, the beneficiary is the central figure in the trust relationship—the trust's reason for being. *See infra* pp. 29–30. As these points show, the state supreme court erred by treating Ms. Kaestner as a "third party" to the trust that bears her own name.

Once formalism is cast aside, the analysis here becomes simple. Ms. Kaestner and her children lived in North Carolina throughout the tax years at issue. North Carolina offered them wide-ranging protection and services—benefits that spared the Trust from having to pay for equivalent services. Those benefits and protections made it only fair for North Carolina to demand a return in the form of trust-income taxes. *See infra* pp. 34–37.

For all these reasons, North Carolina has far more than a "minimum connection" with the Kaestner Trust. The state's connection with the Trust satisfies the first element under *Quill*.

The tax here also satisfies the second element under *Quill*. The tax was "rationally related to values connected with" North Carolina. *Quill*, 504 U.S. at 306. One hundred percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians.

In sum, due process does not justify the doctrine that the Trust seeks here: a rule that the only state that can tax trust income is the state where a trustee lives.

That rule would construct a "judicially created tax shelter" of the first magnitude. *Wayfair*, 138 S. Ct. at 2094. If that rule became the law, any rational grantor would choose a trustee in a state without trust-income taxes. That choice, moreover, would not require much effort: Trust companies and online services stand ready to assign favorably located trustees.

These tax-reducing strategies are far from hypothetical. In this case, the Rice and Kaestner families used similar strategies. The families' trusts worked with trustees in Florida and Connecticut, states with no applicable trust-income taxes.

Trusts generate 120 billion dollars of our nation's income every year. In view of that figure, an endorsement of the tax shelter the Trust seeks here would harm the fiscal health of many states. *See infra* pp. 41–43.

For these reasons and others, the Due Process Clause does not mandate the judicially created tax shelter that the Kaestner Trust is seeking.

ARGUMENT

I. The Due Process Clause does not prohibit a state from taxing a trust with beneficiaries in that state.

A. The two-part test in *Quill* governs the due-process analysis here.

As the Framers recognized, the states have always had "an independent . . . authority to raise their own revenues for the supply of their own wants." The Federalist No. 32, at 197 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

The states' authority to tax is a cornerstone of federalism. As Chief Justice Marshall noted in *McCulloch v. Maryland*, "the power of taxing the people and their property, is essential to the very existence of government." 17 U.S. (4 Wheat.) 316, 428 (1819). This power covers "[a]ll subjects over which the sovereign power of a state extends." *Id.* at 429.

Acting on these principles of federalism, this Court has cautioned that the "modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible." *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108, 110 (1871).

This Court's modern case law on tax jurisdiction embraces these principles of federalism. As recently as last Term, the Court described state taxes as a "valid exercise of the States' sovereign power." *Wayfair*, 138 S. Ct. at 2096.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court applied the Due Process Clause consistently with the above principles. The Court held that, in a due-process challenge to a tax, the taxpayer must satisfy two elements. *Id.* at 306.

First, the taxpayer must show that the taxing state lacks even a "minimum connection[] between [the] state and the person, property or transaction it seeks to tax." *Ibid.* (quoting *Miller Bros.*, 347 U.S. at 345).

Second, the taxpayer must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.'" *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

Both of these tests center on "fundamental fairness." *Quill*, 504 U.S. at 312. To test for fairness, this Court asks whether the state's exercise of jurisdiction is related to the benefits and protections that the state has provided—that is, "whether the state has given anything for which it can ask [for taxes in] return." *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24–25 (2008) (quoting *ASARCO Inc. v. Idaho Tax Comm'n*, 458 U.S. 307, 315 (1982)).

This fairness-based analysis has replaced the rigid, presence-focused analysis that prevailed in the years after *Pennoyer*, 95 U.S. 714. In *Quill*, the Court eliminated the "physical presence" rule under the Due Process Clause. *Quill*, 504 U.S. at 308. The Court also

warned against using other "formalistic tests" to assess jurisdiction to tax.[9] *Id.* at 307.

Just last Term, the Court underscored these principles in *Wayfair*, 138 S. Ct. 2080. The Court reaffirmed *Quill*'s holding that a taxpayer "need not have a physical presence in a state to satisfy the demands of due process." *Id.* at 2093 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985)). The

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[9] This shift away from presence-based tests parallels developments in the area of jurisdiction to adjudicate. *See*, *e.g.*, *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 319 (1945); *see also Daimler AG v. Bauman*, 134 S. Ct. 746, 761 n.18 (2014) (noting this shift in adjudicative-jurisdiction doctrine).

Although tax jurisdiction parallels adjudicative jurisdiction in many respects, the two are not identical. *See Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). As Justice Scalia discussed in *Quill*, tax jurisdiction resembles prescriptive jurisdiction: a state's power "to make its law applicable to the activities, relations, or status of persons, or the interests of persons in things." Restatement (Third) of Foreign Relations Law § 401 (Am. Law Inst. 1987); *see Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). Adjudicative jurisdiction, in contrast, describes a state's power "to subject persons or things to the process of its courts or administrative tribunals, whether in civil or in criminal proceedings, whether or not the state is a party to the proceedings." Restatement (Third) of Foreign Relations Law § 401.

Because adjudicative jurisdiction and tax jurisdiction play different roles, one should take care before applying precedents from one sphere in the other sphere. *Cf.* Pet. App. 13a, 17a (relying extensively on *Walden v. Fiore*, 571 U.S. 277 (2014), and *Hanson v. Denckla*, 357 U.S. 235 (1958), decisions on adjudicative jurisdiction).

Here, there is no dispute over adjudicative jurisdiction, because Ms. Kaestner's Trust sued the Department in North Carolina's courts.

Court also condemned "arbitrary, formalistic" distinctions that lower courts had used to "prevent States from collecting taxes." *Wayfair*, 138 S. Ct. at 2092.

Through these decisions, the Court has repeatedly cautioned that a proper due-process analysis of taxation centers on fairness, not formalism. That movement away from formalism is especially important in this case.

B. Under the Due Process Clause, a trust beneficiary's contacts with a state justify taxing her trust.

1. For due-process purposes, a trust is an abstraction, not a distinct legal entity.

Here, the state supreme court reasoned that for the Kaestner Trust to have a constitutionally valid connection with North Carolina, the connection would have to involve the "trust itself." Pet. App. 18a. The court's reasoning overlooked this Court's analysis of the relationship between states and trusts.

American law has traditionally refused to recognize a trust as "a distinct legal entity." *Americold*, 136 S. Ct. at 1016.

Instead, this Court has described a trust as an "abstraction." *Greenough v. Tax Assessors*, 331 U.S. 486, 493 (1947) (quoting *Anderson v. Wilson*, 289 U.S. 20, 27 (1933)). That description reflects the reality that a

trust is "not a legal person." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 712, at 273 (2009) [hereinafter Bogert]; *cf. Taylor v. Davis' Adm'x*, 110 U.S. 330, 335 (1884) ("[t]he trust estate cannot promise").

In *Americold*, the Court clarified the nature of a trust. 136 S. Ct. at 1016. The Court explained that a trust is merely a "'fiduciary relationship' between multiple people."[10] *Ibid.* (quoting Restatement (Second) of Trusts § 2 (1957)); *accord* Restatement (Third) of Trusts § 2 (Am. Law Inst. 2012).

That fiduciary relationship begins when the grantor of an irrevocable trust contributes property to the trust. Unif. Trust Code § 103 (Unif. Law Comm'n 2000); Bogert, *supra*, § 1, at 8–10. The people in the fiduciary relationship itself are the trust beneficiary and the trustee. Bogert, *supra*, § 1, at 11.

The beneficiary is the person for whose benefit the trustee holds the trust property. *Ibid*. "The trustee is the individual or entity (often an artificial person such as a corporation) that holds the trust property for the benefit of [the beneficiary]." *Id.* at 7. These two people—in some cases, multiple people—are the ones who make up the trust relationship. *Americold*, 136 S. Ct. at 1016.

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[10] Because of the abstract nature of a trust, *Americold* held that a real-estate-investment trust does not have a distinct entity-level citizenship for purposes of diversity jurisdiction. 136 S. Ct. at 1016.

When the North Carolina Supreme Court applied due-process analysis here, it misunderstood how that analysis applies to trusts. The court treated the Kaestner Trust as a separate legal entity. Pet. App. 12a. Taking this "separate entity" theory further, the court held that, for due-process purposes, Ms. Kaestner is a "third party" to her trust. Pet. App. 13a. The court cited *Brooke v. City of Norfolk*, 277 U.S. 27 (1928), for the proposition that a trust and its beneficiaries are separate for tax purposes. Pet. App. 12a–13a.

That "separateness" theory was rejected, however, in *Stone v. White*, 301 U.S. 532 (1937). There, in the context of a tax-refund claim, this Court equated trusts' interests with beneficiaries' interests. The Court held that when a trust pays a tax, "only [the beneficiary] is ultimately burdened." *Id.* at 538. Thus, the Court refused to "shut its eyes to the fact that in the realm of reality it [is] the beneficiary's money which [pays] the tax." *Id.* at 535.

When the state supreme court held that Ms. Kaestner is a mere third party to her trust, the court also cited *Hanson v. Denckla*, 357 U.S. 235 (1958). *Hanson*, however, does not control here. The issue there was adjudicative jurisdiction over a *trustee*, not tax jurisdiction over a trust. *Id.* at 253. The *Hanson* Court had no occasion to decide whether a beneficiary's residency in a state allows that state to tax the beneficiary's trust income.

Based on these and other errors, the state supreme court treated a trust beneficiary as a stranger to the trust that bears her name. That kind of formalism has no place in a modern due-process analysis, which centers on fairness. *See supra* pp. 20–22. Under a fairness-based analysis, it makes no sense to limit the inquiry to the jurisdictional contacts of a mere abstraction.

2. The contacts that count for due-process purposes are the contacts of a trust's constituents.

Because a trust is an abstraction, it cannot have physical contacts with a state. *See Americold*, 136 S. Ct. at 1016 (noting that the "[trust] relationship was not a thing that could be haled into court"). Instead, a trust makes jurisdictional contact with states through the people who make up the trust relationship.

The Court established this principle in *Greenough v. Tax Assessors*, 331 U.S. 486 (1947). There, the Court considered a question closely related to the question here: whether the Due Process Clause barred Rhode Island from taxing a trust based on the in-state residency of a trustee. *See id.* at 488–89. The Court held that the Due Process Clause did not bar such a tax. *Id.* at 498.

The *Greenough* Court began by analyzing the unique, abstract nature of trusts. *Id.* at 493. The Court pointed out that it has treated a trust as an abstraction, not as a separate entity. *Ibid.*

The federal tax code sometimes treats a trust as a separate taxpayer, but the Court described that treatment as a statutory decision, not as a constitutional command. *Id.* at 493–94 ("This is because Congress has seen fit so to deal with the trust.").

In contrast, when the Court assessed the jurisdictional contacts of the trust in *Greenough*, the Court did not treat the trust as a taxpayer with a "separate existence." *Id.* at 493. Instead, the Court focused on the jurisdictional contacts of the trust's *constituents*. *Id.* at 496.

Because of the facts in *Greenough*, the constituent at issue was a trustee. *Id.* at 488. In that context, the Court held that a benefit to a trustee is a benefit to the trust abstraction itself. *Ibid.* Because of the unique relationship between a trust and its constituents, the Court recognized that a trustee's contacts with a state can justify taxing a trust. *Id.* at 496. Through that reasoning, the *Greenough* Court treated a trust and its constituents as inextricably intertwined.[11]

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[11] The same conclusion also flows from one of this Court's key decisions on adjudicative jurisdiction: *Burger King Corp. v. Rudzewicz*, 471 U.S. 462. There, the Court held that the nature and intensity of a relationship can justify a court's exercise of power over a person. *Id.* at 480.

The relationship between a beneficiary and her trust is far more intensive than the franchise relationship at issue in *Burger King*. A beneficiary is not a contractor with a trust; she is the trust's very heart. As shown below, the trust cannot exist without her. *See infra* pp. 29–30.

Greenough's approach is significant, because that decision departs from a *Pennoyer*-era decision on the due-process limits of trust taxation. *See Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929).

In *Safe Deposit*, the Court held that Virginia could not assess property taxes on trust property that was being held in Maryland for a Virginia beneficiary. *Id.* at 94. *Safe Deposit* applied a rigid, *Pennoyer*-era due-process test—one that turned on the literal taxpayer's "actual presence" in the taxing state. *Id.* at 92.

The taxpayer at issue in *Safe Deposit* was a trust. *Id.* at 90. Under *Pennoyer*-era reasoning, once the Court decided that the trust property itself was not physically present in the taxing state, the case was over. *Ibid.* The Court expressly declined to consider whether, in light of the trust relationship, the contacts of the trust's beneficiaries should count for due-process purposes. *See id.* at 92 ("We need not make any nice inquiry concerning the ultimate or equitable ownership of the [trust property] or the exact nature of the interest held by the [beneficiaries].").

Greenough—a case decided a generation after *Safe Deposit* and two years after *International Shoe*—shows how the Court's analysis of trust contacts has turned away from formalism. In *Greenough*, the Court did what it declined to do in *Safe Deposit*: It examined the nature of the trust relationship, rather than

focusing on the literal taxpayer's physical presence. *See Greenough*, 331 U.S. at 493. By performing that analysis, the Court showed that the contacts of the people in the trust relationship count in a due-process analysis.

When one compares *Greenough* with *Safe Deposit*, it becomes clear that one decision involves a modern due-process analysis, and one does not. *Greenough*, with its emphasis on fairness, tracks a modern due-process analysis. *Safe Deposit*, with its formalistic, presence-based reasoning, clashes with this Court's modern teachings on due process.[12] *See supra* pp. 20–22 (discussing those teachings).

In the related context of adjudicative jurisdiction, this Court has cautioned that *Pennoyer*-era precedents "should not attract heavy reliance today." *Daimler*, 134 S. Ct. at 761 n.18. Discarding *Safe Deposit* and upholding *Greenough* would reinforce that caution.

In sum, the analysis here should follow the central point of *Greenough*: In trust-tax cases, the contacts of the people in the trust relationship are the contacts that matter.

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[12] *Safe Deposit* is no longer good law for another reason as well: It is premised on the view that the Due Process Clause prohibits double taxation. 280 U.S. at 92. The Court later abandoned that view in *Curry v. McCanless*, 307 U.S. 357, 363 (1939). *See*, *e.g.*, *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 803 (Conn. 1999) (noting that concerns over double taxation were "[c]entral to the Court's reasoning in *Safe Deposit*," but that those concerns had "long been abandoned as a limitation on taxation under the due process clause").

3. A trust beneficiary is a constituent of a trust—indeed, the most important constituent.

As shown above, *Greenough* holds that trustees' in-state residency justifies state taxes on trusts.

That conclusion applies with even greater force when the state resident at issue is a trust beneficiary. As shown below, a beneficiary is not only another constituent of a trust; she is a trust's most important constituent. Because of a beneficiary's central role in a trust, her residency in a state forms the required link between the taxing state and the trust. *See Quill*, 504 U.S. at 327 (requiring such a link).

The beneficiary is a trust's reason for being. Under settled principles of trust law, a trust exists solely "for the benefit of its beneficiaries." Unif. Trust Code § 404 (Unif. Law Comm'n 2000). The trust abstraction is simply "incidental to and derivative of the purpose of benefiting the trust beneficiary." Kent D. Schenkel, *Trust Law & the Title-Split: A Beneficial Perspective*, 78 UMKC L. Rev. 181, 183 (2009). Indeed, a trust cannot exist without beneficiaries. *See* Restatement (Third) of Trusts § 44 (Am. Law Inst. 2012).

A trust beneficiary, moreover, has an ownership interest in trust property—a "right, title, and estate in and to" that property. *Commonwealth v. Stewart*, 12 A.2d 444, 447 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941). In contrast, a trustee's interest in trust property is "merely nominal, with real ownership

remaining in the beneficiary." John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 181 (1997).

As these points show, a beneficiary is not just one of the people in the trust relationship; she is the *most important* person in that relationship.

4. The benefits and protections that states give a trust beneficiary justify taxing her trust.

Because of the central role that a beneficiary plays in a trust, the principle of *Greenough* applies equally to this case. Under that principle, a trust constituent's residency in a state connects the trust to the state. *See Greenough*, 331 U.S. at 495; *see also McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 419 (Cal. 1964) (same); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 802 (Conn. 1999) (same).

Another principle in *Greenough* applies here as well: The benefits and protections that a state gives a trust constituent justify taxing the trust.

In *Greenough*, the Court pointed out that the trust constituent at issue, the trustee, was "entitled to the same advantages from Rhode Island laws as [was] any natural person there resident." 331 U.S. at 495.

The Court also stressed the many benefits and protections that Rhode Island gave the trustee. The state offered the trustee all of the "benefits and protection inherent in the existence of an organized

government," including the "privileges of citizenship" and "the protection of his domiciliary government." *Id.* at 493.

The Court held, moreover, that it did not matter whether the trust constituent actually used these benefits; all that mattered was that he had the opportunity to do so. *See ibid.* The Court upheld the tax at issue even though "nothing appeared as to any specific benefit or protection which the trustee had actually received." *Id*. at 495.

The benefits and protections that a state offers a trust beneficiary are even more important than the benefits that a state offers a trustee. *See id.* at 493–97 (citing those benefits).

The fulfillment of a trust's purpose—serving the trust beneficiary—"assumes solvent state and local governments." *Wayfair*, 138 S. Ct. at 2096. That purpose depends on the benefits that a state confers by maintaining "an orderly, civilized society." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

For example, if a beneficiary's home state did not protect "sound local banking institutions," a trust could not make secure distributions to the beneficiary. *Wayfair*, 138 S. Ct. at 2096 (quoting *Quill*, 504 U.S. at 328). More fundamentally, if the beneficiary did not receive the physical protection and security that her state government provides, including the "police and fire departments that protect [her]," she would be in no position to receive or enjoy her distributions. *Wayfair*, 138 S. Ct. at 2096; *see also* Ilya Somin, *Revitalizing*

Consent, 23 Harv. J.L. & Pub. Pol'y 753, 759 (2000) (describing the enormously expensive services that states provide).

Indeed, state benefits and protections relieve a trust from making outlays on its beneficiaries' behalf. For example, a common purpose of a trust is to pay for beneficiaries' education. Restatement (Third) of Trusts § 50 cmt. d(2) (Am. Law Inst. 2012). All states, however, offer free public schools to their school-age residents. Because a state offers that expensive service for free, a trust that has a duty to provide for the education of its beneficiaries need not spend thousands of dollars per year on private schools. Free education and other taxpayer-subsidized benefits allow a trust to save its income and garner investment returns.

The privileges that flow from a beneficiary's in-state residency "are inseparable from responsibility for sharing the costs of government." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937). As Justice Holmes famously observed, "taxes are what we pay for [a] civilized society." *Compania Gen. de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

This close relationship between state taxation and state protection of trust beneficiaries has led other state courts to uphold state trust taxes against due-process claims.

In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, for example, the Connecticut Supreme Court drew the same parallel to *Greenough* that this brief draws. *See*

supra pp. 30–31. The court held: "[J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws[,] it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits." *Id.* at 802 (citing *Greenough*, 331 U.S. at 496).

Likewise, in *McCulloch v. Franchise Tax Board*, 390 P.2d 412, the California Supreme Court agreed that a beneficiary's home state can tax undistributed trust income. The court emphasized the protection that a state offers a trust during the years when the trust is accumulating income. During those years, the state gives the beneficiary "the interim protection of its laws so that [she] may ultimately obtain the benefit of the accumulated income." *Id.* at 419.

As these courts rightly held, a trust beneficiary's residency in a state gives her, and her trust, enormously valuable services and protection. Those services, plus the close connection between the beneficiary and the trust, establish the required connection between the state and the trust. *See Quill*, 504 U.S. at 306. That principle decides this case.

C. Ms. Kaestner's residency in North Carolina justifies the state's exercise of tax jurisdiction over her trust.

As shown above, the Trust's due-process challenge to North Carolina's trust-tax statute is governed by the

two-part test that this Court announced in *Quill*. *See Quill*, 504 U.S. at 306; *supra* p. 20.

The statute satisfies both parts of the *Quill* test.

1. Ms. Kaestner's North Carolina residency satisfies the first element of *Quill*.

As applied to the Kaestner Trust, North Carolina's trust-tax statute satisfies the first element of the *Quill* test, the "minimum connection" element. As shown above, when a trust beneficiary lives in a state, so does her trust. Here, the beneficiaries of the Kaestner Trust were North Carolina residents during the tax years at issue.

As in-state residents, Ms. Kaestner and her children were offered all of the taxpayer-funded benefits and protections that come with residency in North Carolina. These benefits and protections parallel the benefits that, *Greenough* held, would justify the exercise of tax jurisdiction over a trust. 331 U.S. at 493–97; *supra* pp. 30–31.

Indeed, the case for taxation here is even stronger than in *Greenough*. There, the Court noted that the record did not show "any specific benefit or protection" that any trust constituent had actually received. *Greenough*, 331 U.S. at 495. Here, in contrast, Ms. Kaestner received wide-ranging benefits and protections from North Carolina. In fact, those state benefits replaced services that the Trust otherwise would have had to buy for Ms. Kaestner.

For example, one of the Trust's purposes was "to provide for [its beneficiaries'] education." App. 51. North Carolina gave Ms. Kaestner the opportunity to send her children to the state's excellent public schools at no charge. Indeed, the North Carolina Constitution secured the children's right to a free education in the public schools. N.C. Const. art. I, § 15 ("The people have a right to the privilege of education, and it is the duty of the State to guard and maintain that right."); *id.* art. IX, § 2(1) (mandating "free public schools").

Similarly, before the tax years at issue, Ms. Kaestner enrolled at the University of North Carolina at Chapel Hill and earned a master's degree. App. 81. North Carolina's taxpayers subsidized that public university. *See* N.C. Gen. Stat. §§ 116-4, -144. During the tax years at issue, if Ms. Kaestner wished to pursue further studies in the UNC system, those educational services were available to her at taxpayer-subsidized rates. *See* App. 81.

Another one of the Kaestner Trust's main purposes was to provide for the beneficiaries' health and welfare. App. 51. North Carolina shouldered that responsibility by giving Ms. Kaestner and her children all of the critical public-safety services needed to protect their health and welfare, including police and fire departments. *See Wayfair*, 138 S. Ct. at 2096. By taking on those responsibilities, North Carolina relieved the Trust of the enormous expense that equivalent services would have required.

The trust instrument also directed the trustee to help Ms. Kaestner if she "set[] up a business." App. 51. When Ms. Kaestner did so, North Carolina's state government stepped in again to help the Trust. Near the end of the tax years at issue, the Trust loaned Ms. Kaestner $250,000 to invest in commodities. Pet. App. 3a. That loan was facilitated by North Carolina's sound local banking institutions. *See Wayfair*, 138 S. Ct. at 2096. If the loan had generated any legal disputes, North Carolina's state courts and state laws were at hand to resolve those disputes. *See Greenough*, 331 U.S. at 495–97 (citing the availability of a state's legal system as a benefit to a trust).

In these ways and more, North Carolina benefited the Kaestners by maintaining the "orderly, civilized society" that made their lifestyle in North Carolina possible. *J.C. Penney*, 311 U.S. at 444.

In view of those benefits, as well as the inseparable relationship between Ms. Kaestner and her trust, her life in North Carolina establishes the required "minimum connection" between North Carolina and the Trust. That connection satisfies the first element under *Quill*.

2. North Carolina's limited tax satisfies the second element of *Quill*.

This case also satisfies the second element of *Quill*: North Carolina's taxation of the Trust's income was "rationally related to values connected with" the

state. *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

The state supreme court did not reach this issue. *See* Pet. App. 10a ("[I]n this case we are concerned only with the first [*Quill*] requirement."). Even so, the record makes clear that the tax at issue satisfies the second element under *Quill*.

North Carolina taxed Ms. Kaestner's Trust only on income that was earned for Ms. Kaestner's benefit. North Carolina's statute taxes only "the amount of the taxable income . . . that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2. That narrowing language ensures that North Carolina's trust taxes are apportioned to match the interests held by North Carolina beneficiaries.

Here, 100 percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians. The Trust's own complaint alleged that, during the tax years at issue, the Trust's "current beneficiaries" were "Kimberly Rice Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina." App. 11. Thus, the share of the Trust's income that was connected with North Carolinians—and therefore connected with state services to those North Carolinians—was 100 percent. That was the share of the Trust's income that North Carolina taxed. *See Moorman*, 437 U.S. at 269.

*   *   *

For these reasons, North Carolina's trust-tax statute, as applied to the Kaestner Trust, satisfies both elements of the *Quill* test. By reaching the opposite conclusion, Pet. App. 18a, the state supreme court made an error of federal constitutional law.

II. The Due Process Clause does not mandate the tax shelter that the Trust seeks here.

As shown above, when trust beneficiaries live in a taxing state, taxing trust income comports with due process. That conclusion becomes even clearer when one considers the harmful effects of the opposite rule that the state supreme court applied here. That rule is no better than a judicially created tax shelter—a type of doctrine that this Court has not hesitated to reject.

A. This case presents an opportunity for the Court to reject a judicially created tax shelter.

In the recent *Wayfair* decision, the Court condemned "judicially created tax shelter[s]" in the context of sales taxes. *Wayfair*, 138 S. Ct. at 2094. This case presents an opportunity for the Court to close an equally undesirable tax shelter: one that shelters massive trust income from state taxes.

In 2014 alone, trusts filed more than 2.7 million federal tax returns. Collectively, those trusts reported income of more than 120 billion dollars.[13]

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[13] *See* Internal Revenue Service, SOI Tax Stats—Fiduciary Returns—Sources of Income, Deductions, and Tax Liability—Type of Entity: 2014, *available at* https://www.irs.gov/statistics/soi-tax-stats-fiduciary-returns-sources-of-income-deductions-and-tax-liability-by-type-of-entity. This figure includes returns filed on behalf of complex trusts, simple trusts, grantor trusts, qualified-disability trusts, split-interest trusts, and pooled-income funds. It does not include returns filed on behalf of

Taxes on these billions of dollars are a critical source of funding for states' essential government services. At least eleven states currently tax undistributed trust income when a trust beneficiary lives in the taxing state. *See supra* p. 6 n.1.

The result the Trust seeks here, however, would make it possible for trusts to shelter their entire undistributed income from state income taxes. To achieve that result, all a trust would need to do is select a trustee in a state that does not tax trust income based on the trustee's residency—for example, Connecticut, where Mr. Bernstein lived, or Florida, where the predecessor trustee lived. *See supra* p. 10.

After selecting such an out-of-state trustee, beneficiaries like Ms. Kaestner could live in their home states, consume state resources, and accept other protections from the state on a tax-free basis.

Indeed, the ruling that the Kaestner Trust seeks would allow beneficiaries to avoid paying state income taxes forever. Beneficiaries like Ms. Kaestner could accumulate income in their trusts over several decades, avoid taxes on that income, and then, before taking a distribution from their trusts, simply move to a state without income taxes.

This tax shelter, if endorsed by this Court, would create an opportunity that few trusts could resist. As scholars agree, trusts are "particularly well suited" for

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decedents' estates, Chapter 7 bankruptcy estates, and Chapter 11 bankruptcy estates.

"fiscal and regulatory avoidance." Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434, 479 (1998).

Unlike a human being, a trust can change its situs instantaneously. *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, 85 Cornell L. Rev. 1035, 1065 (2000). For example, "[f]or a California trust to relocate to Alaska, no individual has to change her domicile. A trust can relocate to Alaska without the use of bricks or mortar." *Ibid.*

Indeed, in this age of widespread online services, technology has made it remarkably easy to select a trustee in a state with no trust-income tax.[14] If a trust has an existing trustee in a state with unfavorable tax laws, a beneficiary can simply "request that the trustee resign." Jay A. Soled & Mitchell M. Gans, *Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century*, 72 Wash. & Lee L. Rev. 257, 277 n.129 (2015).

Because of these options, "mov[ing] an income-accumulation trust from a high income tax state to a low income tax state" is now "[o]ne of the most significant reasons for moving the situs of [an existing]

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14 For example, Charles Schwab Trust Company offers trustee services, promising to "leverag[e] the advantages of a favorable trust situs" in Nevada, a state that does not tax trust income. Charles Schwab Trust Company, https://www.schwab.com/public/schwab/investing/accounts_products/personal_trust_services (last visited Feb. 20, 2019).

trust." John Warnick & Sergio Pareja, *Selecting a Trust Situs in the 21st Century*, 16 Probate & Property 53, 57 (2002).

These techniques have led sophisticated planners to view trusts as "an income tax savior." Soled & Gans, *supra*, at 280. Empirical studies have shown that record amounts of assets have started flowing into trusts. *See* Robert Sitkoff & Max Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356, 391 (2005). A study that tracked the aggregate assets in trusts from 1985 through 2003 showed an increase from 400 billion dollars to 1.2 trillion dollars. *See ibid.*

In sum, the rule of constitutional law that the Trust seeks here would endorse "an extraordinary stratagem by which wealthy individuals are able to avoid all state income taxes on investment income through the use of a carefully crafted out-of-state trust." Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 Vand. L. Rev. 1945, 1997 (2014).

Such a rule would also end the states' ability to adopt tax approaches that would combat this tax-avoidance technique. Sound principles of federalism counsel against such a result. *See Dows*, 78 U.S. at 110 ("[The] modes adopted [by the states] to enforce the

taxes levied should be interfered with as little as possible.").

Finally, constitutionalizing the tax shelter at issue here would deprive the states of hundreds of millions of dollars in tax revenue annually—losses that could reach a billion dollars in North Carolina over the next decade alone. Pet. 13.

Just last Term, this Court struck down a similar tax shelter, expressing concern over the "significant revenue losses to the States" that the tax shelter posed. *Wayfair*, 138 S. Ct. at 2093–94. The same ruling is justified here.

B. The Trust has actively sought to exploit the tax shelter at issue.

The facts of this case are a graphic example of the tax avoidance that would be produced by the rule the Trust seeks here.

During the tax years at issue, Ms. Kaestner expressed alarm to her trustee, Mr. Bernstein, about the number of expensive lawyers who were working to optimize her trust arrangements. N.C. R. p. 225. Mr. Bernstein reassured her that the legal fees would be "immaterial compared to the major tax savings" that the lawyering would achieve. N.C. R. p. 225.

If the Trust prevailed here, that outcome would prove Mr. Bernstein right.

As noted above, the predecessor of the Kaestner Trust, the Rice Family Trust, used a Florida trustee for

a decade.[15] Florida has no income tax, so the trust avoided state income taxes in Florida during those years.

In 2005, the Florida trustee was replaced by a Connecticut trustee, Mr. Bernstein. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone.[16] Thus, the Rice Family Trust avoided state taxes in Connecticut as well.

Having avoided taxes in Connecticut, Mr. Bernstein then challenged New York's jurisdiction to tax the Rice Family Trust's income. He invoked the Due Process Clause, arguing that the trust lacked sufficient connections to New York. App. 76–79. On that basis, the trust avoided any residency-based taxes in the Empire State. Instead, it reported only $2,165 in income from New York sources—less than 0.1% of the trust's income that year. App. 76–79.

In North Carolina, in contrast, the Kaestner Trust faced a more significant challenge to its tax-avoidance efforts. North Carolina assessed income taxes on the Trust, because the Trust's beneficiaries lived in North Carolina and had access to extensive state services. *See supra* pp. 34–36.

To resist those taxes, the Trust filed this lawsuit. Although Mr. Bernstein had argued a few years earlier that the Trust's predecessor had insufficient

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15 Mr. Matteson, the original trustee, moved to Florida in 1995. App. 11.

16 *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

connections with New York, he argued to the North Carolina courts that the Kaestner Trust was "a trust with a situs in New York." App. 9.

Those tactics, so far, have enabled the Kaestner Trust and its predecessor to avoid state income taxes on virtually all of their income during the years described above.

During these years of maneuvering, there was one constant: North Carolina remained home to Ms. Kaestner, the beneficiary of the trust that bears her name.

If the Trust prevails here, it will have benefitted from Ms. Kaestner's consumption of North Carolina's services for years, yet will have avoided paying any trust-income taxes to fund those services. That outcome would clash with the "traditional notions of fair play and substantial justice" that shape modern analysis under the Due Process Clause. *International Shoe*, 326 U.S. at 320.

CONCLUSION

The state supreme court's decision should be reversed.

Respectfully submitted,

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No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

ON WRIT OF CERTIORARI TO
THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

May a State assert jurisdiction over a nonresident trustee based solely on the fact that a contingent beneficiary resides in that State?

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INTRODUCTION

This case concerns North Carolina's attempt to exercise jurisdiction over a person with whom it has no contacts. That person, a nonresident trustee, did not engage in any conduct purposefully availing himself of North Carolina, and the State disavows any argument to the contrary. Instead, the State seeks to base jurisdiction on a single fact: that a different person, a contingent trust beneficiary, happened to reside there.

Relying on that fact alone, the State taxed the nonresident trustee on the worldwide income of the trust property. The State imposed that tax even though the beneficiary was unaware of the trust for most of its existence, did not meet the trustee until halfway through the four-year tax period, and neither received nor was entitled to any trust income during the years involved.

All of the North Carolina courts rejected the State's assertion of power as a violation of fundamental principles of due process. Those decisions are correct and should be affirmed.

This Court has twice addressed and resolved the question presented, including in the foundational case of *Hanson v. Denckla*, 357 U.S. 235 (1958). There, the Court held that a State may not assert jurisdiction over a nonresident trustee based solely on the fact of a beneficiary's forum residence. That case resolves this one. The same result follows from the core principles this Court has applied in evaluating due process limits on state jurisdiction under *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

The State asks the Court to ignore the precedents that govern this case. Instead, the State justifies its jurisdictional overreach with exaggerated and misplaced policy concerns about the impact of the decision below on tax revenues. In reality, States have ample means of taxing trust income in ways that the decision below does not affect. At issue here is a highly unusual tactic that very few States have even attempted.

Ultimately, North Carolina's grievance is not that the States lack constitutional power to tax, but rather that the States with constitutional power to tax have chosen not to exercise it. That disagreement with the policy decisions of voters in other States does not grant North Carolina license to expand its jurisdiction beyond settled constitutional bounds.

STATEMENT OF THE CASE

I. THE TRUSTEE OWNED AND CONTROLLED THE TRUST PROPERTY, AND THE BENEFICIARIES HAD NO VESTED RIGHT TO TRUST ASSETS

The trust in this case was created in 1992 by a written agreement between a New York settlor and a New York trustee. The agreement granted the trustee ownership of the trust property and absolute discretion to control all trust matters, including investments and distributions. The beneficiaries were third parties to that agreement, with no present right to trust income or principal nor any guarantee that they would ever receive either.

A. The Agreement Between the Settlor and Trustee Granted the Trustee Absolute Discretion over the Trust Property

The settlor established the trust when he executed an agreement with the trustee "assign[ing], transfer[ring], and convey[ing] to the trustee" all of the trust property. App. 45. A non-grantor trust in the traditional common law model, the trust was "irrevocable and unamendable by the Settlor." Art. 10, App. 69. The settlor retained no control over the transferred assets.

Instead, the agreement bestowed "absolute discretion" over the administration and disposition of the trust property on the trustee. Art. 1 §§ 1.1, 1.2, 1.4, App. 45–46, 50–51. The trustee was empowered to "do all such acts, take all such proceedings and exercise all such rights and privileges . . . with respect to any such property, as if the absolute owner thereof and in connection therewith to make, execute and deliver any instruments and to enter into any covenants or agreements binding any trust hereunder." Art. 5 § 5.2(r), App. 60. Under the agreement, the trustee would make distributions of assets only "as the Trustee in the Trustee's absolute discretion may from time to time determine." Art. 1 § 1.1, App. 46. The trustee was also entitled to terminate the trust "at any time in [his] discretion." Art. 2, App. 51–52.

B. The Beneficiaries Did Not Own or Control the Assets and Were Not Guaranteed Ever to Receive a Distribution

The trust agreement conferred no property or authority on the beneficiaries, who were defined only as "a class of persons consisting of the Settlor's

descendants, whenever born." Art. 1 § 1.1(a), App. 45. In addition to that class of contingent primary beneficiaries, the trust identified as secondary beneficiaries the settlor's spouse and sister. App. 52.

Because the trustee had sole and absolute discretion over trust administration, the beneficiaries could not compel distributions of any income or principal for any reason, including for financial support or for their health, education, or welfare. Art. 1, App. 44–46, 51. To guide the trustee's discretion, the trust agreement identified certain milestones that might warrant distributions, Art. 1 § 1.4, App. 50–51, but the power to make decisions about when, whether, and how to distribute trust property remained solely with the trustee. *Id.*

The trust agreement explicitly prohibited the beneficiaries from alienating or assigning trust property. Art. 12, App. 70–71. The beneficiaries' creditors could not reach trust assets, even upon the death of the beneficiaries, because the trust agreement prevented a beneficiary from appointing the balance of her interest to her estate creditors prior to termination. Art. 1 § 1.2(c)(2)(i), App. 47–48. The beneficiaries were not provided the right to influence, or even to receive notice of, investment decisions.

Any particular contingent beneficiary, moreover, was not guaranteed ever to receive any funds from the trust. The trustee was specifically empowered to pay some or all trust property to any one member of the contingent beneficiary class to "the exclusion of other [beneficiaries] in such manner as the Trustee may deem advisable." Art. 1 § 1.4, App. 50. Thus, although the trust contemplated distribution of

assets to each of the settlor's descendants as they reached age 40, Art. 1, § 1.2(c)(1), App. 47, by that time the trustee could have distributed the entire trust to other beneficiaries. In addition, New York law permitted the trustee to exercise his discretion not to distribute on the beneficiary's fortieth birthday and instead to decant the assets into a new trust without the termination provision. N.Y. Est. Power & Tr. Law § 10-6.6(b); App. 96.

Ultimately, the contingent beneficiaries' only right with respect to the trust property was standing to sue. If a beneficiary disagreed with the trustee's decisions, she could bring an equitable action in New York alleging that the trustee abused his discretion. Restatement (Third) of Trusts § 50 (Am. Law Inst. 2003) ("A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee."). Such a suit would face a formidable standard, requiring a showing of "abuses that are arbitrary or the result of bad faith." *Haynes v. Haynes*, 900 N.Y.S. 2d 22, 22 (N.Y. App. Div. 2010).

II. THE TRUSTEE HAD NO CONTACTS WITH NORTH CAROLINA

From its creation, the trust agreement and property had nothing to do with North Carolina. The trustee had no connection with that State, before or after the contingent beneficiary moved there.

A. The Trust Agreement, Trust Property, Settlor, and Trustees Had No North Carolina Contacts

The settlor and initial trustee were both residents and domiciliaries of New York. App. 39. They

executed the trust agreement in New York, App. 75, and specified that it was subject to New York law. Art. 10, App. 69.

None of the trust property was located in North Carolina, and none of the trust income was derived directly from a North Carolina source. App. 41–42. The trust assets did not include any real property, in North Carolina or elsewhere. App. 41. The custodian of the trust assets was located in Massachusetts. *Id.* Other ownership documents and records were kept in New York. *Id.*

The initial trustee moved to Florida in 1995 and continued to administer the trust until he retired in 2005. App. 39. The settlor then appointed as trustee David Bernstein, who remained in that position during the relevant period. App. 39–41. Bernstein, who paid the tax at issue, was a resident and domiciliary of Connecticut when the settlor appointed him and throughout the relevant tax years. App. 40–41.[1]

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[1] The trust agreement contemplated an initial term of 10 years, after which the trustee would divide the trust into separate shares for each of the settlor's then-living children, or if deceased, the children's then-living descendants. Art. 1 §§ 1.1, 1.2, App. 45–46. In 2002, the initial trustee informally divided the trust into three separate sub-trusts. App. 91. Bernstein formalized the division into separate trusts, including the named respondent here. App. 92. The same trust agreement continued to govern. Art. 1 § 1.2, App. 46.

B. The Trustee and Trust Property Had No Contacts with North Carolina as a Result of the Beneficiary's Residence

In 1997, five years after the trust's creation, one of the settlor's children, Kimberley Kaestner, moved to North Carolina. App. 11. During the tax years at issue, Ms. Kaestner, a contingent beneficiary, lived with her family in that State. *Id.*

For 10 years after she moved to North Carolina, and for the first 15 years the trust existed, Ms. Kaestner had no contact at all with the trustee. App. 84–86. The initial trustee and Ms. Kaestner were literal strangers; they never met or interacted. App. 83. Indeed, Ms. Kaestner did not even know that the trust existed when she moved to North Carolina. App. 84. She did not learn about the trust until nearly a decade later, in 2006—the second of the four tax years at issue—and her first meeting with Bernstein about the trust was not until 2007 in New York. App. 121, 106–07.

For the rest of the tax period, the trustee's interactions with Ms. Kaestner were "very infrequent[]." App. 127. He did not regularly inform her about the trust's performance, nor did he send her annual or quarterly reports about its status. *Id.*

There is no support for the State's incorrect assertion that the trustee "administered the Trust to satisfy Ms. Kaestner's needs." Pet. Br. 8.[2] In fact,

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[2] The State mischaracterizes the record in several respects to portray inaccurately the interactions between trustee and beneficiary. It states, for example, that the trustee met with Ms. Kaestner "[o]n at least two occasions." Pet. Br. 8. As the North Carolina Supreme Court explained, "[t]he undisputed *(continued)*

the trustee met with Ms. Kaestner only twice: once in 2007 and once in 2008. App. 106–07. Both meetings took place in New York and consisted of purely informational reports to educate Ms. Kaestner about the trust. App. 103–04. At no point did the trustee seek or accept investment input from Ms. Kaestner or any other beneficiary. App. 42. The trustee had no further meetings with the beneficiary during the tax years and, until this suit was filed, never traveled to North Carolina in his trustee capacity. App. 106–07.

Before Ms. Kaestner turned 40 in June 2009, after the tax years in dispute, the trustee exercised his discretion under New York law to decant the trust property into a new trust rather than distribute the assets. App. 96–97.

The trustee never distributed any of the trust income at issue here to Ms. Kaestner or any other North Carolina beneficiary during the tax period. App. 43.

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evidence in the record shows that contact between Bernstein and Kaestner regarding administration of the trust was infrequent—consisting of only two meetings during the tax years in question." Pet. App. 17(a).

Similarly, the State incorrectly asserts that the trustee made a loan to Ms. Kaester "[n]ear the end of the tax years at issue." Pet. Br. 36. As the North Carolina Supreme Court noted, that loan was made in 2009, after the tax period. Pet. App. 3(a). That court correctly concluded that "[a]ny connection between plaintiff and North Carolina based on the loan is . . . irrelevant given that the loan was issued in January 2009, after the tax years at issue." Pet. App. 17(a); *see also* App. 113 (noting that the loan was in 2009).

III. NORTH CAROLINA TAXED THE TRUSTEE ON ALL OF THE TRUST INCOME, AND ALL OF THE NORTH CAROLINA COURTS HELD THE TAX UNCONSTITUTIONAL

North Carolina taxed the trustee on the worldwide income of the trust for the years 2005 to 2008, even though none of that income had been generated in North Carolina or received by a North Carolina resident. The sole basis for the tax was the fact that a contingent trust beneficiary lived there during those years, triggering a statute requiring "the fiduciary responsible for administering the . . . trust [to] pay" tax on the income of the trust property "that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105–160.2 (2017).

The trustee paid under protest and then brought suit in the name of the trust challenging the constitutionality of the tax. All of the North Carolina courts held that the tax violated both the Due Process Clause of the Fourteenth Amendment and the North Carolina Constitution.

The North Carolina Business Court invalidated the tax primarily on the basis of *Quill*, 504 U.S. 298, and the minimum-contacts analysis that case prescribes. The court noted the State's agreement that "the only connection" supporting the tax "is the residence of the beneficiaries." Pet. App. 54a. Premising jurisdiction on that single fact, the court reasoned, failed for a number of reasons. That theory contradicted the fundamental principle that "[t]he focus of the due process inquiry must be on the entity being called upon to pay taxes," *id.* at 51a, and instead "conflat[ed] the beneficiaries' contact[s]" with those of the taxpayer. *Id.* at 54a. Moreover, the

court noted, the State's argument "ignores the undisputed facts that [the beneficiaries] had no control over [trust] assets or ability to generate income from those assets, and had no authority to compel [the trustee] to distribute income." *Id.* at 55a.

The court therefore concluded that the State lacked the minimum connection necessary to justify the tax. The court further held that *Quill* invalidated the tax for the similar reason that the taxed income bore no rational relationship with the State. *Id.* at 58a. In addition, the court reasoned that the tax failed Commerce Clause scrutiny on multiple grounds, including that "the mere presence of the beneficiaries" was not a "substantial nexus" with that State for a tax on undistributed trust income. *Id.* at 65a, 67a–68a.

The Court of Appeals unanimously affirmed the Business Court, concluding that "North Carolina did not demonstrate the minimum contacts necessary to satisfy the principles of due process." Pet. App. 27a. That conclusion rested on the same observations that drove the Business Court's holding and on this Court's decisions addressing due process limits on taxation of trust income. *Id.* at 38a–40a. The Court of Appeals deemed it unnecessary to reach the Commerce Clause.

The North Carolina Supreme Court affirmed. Like the lower courts, that court considered whether the State could tax the trust income "solely based on the North Carolina residence of the beneficiaries during the tax years." Pet. App. 2a. The court reasoned that, under *Quill*'s requirement of a "minimum connection[—]more commonly referred to as minimum contacts"—the taxpayer's "minimum

contacts with the taxing state cannot be established by a third party's" actions. *Id.* at 10a, 13a. Applying this Court's cases elaborating on due process guarantees, the North Carolina Supreme Court concluded that "[w]hen, as here, the income of a foreign trust is subject to taxation solely based on its beneficiaries availing themselves of the benefits of our economy and the protections afforded by our laws, those guarantees are violated." *Id.* at 18a.

One justice dissented. Even that justice, however, did not adopt the State's argument that the fact of a beneficiary's residence alone supports jurisdiction. Instead, the dissenting justice agreed that the "proper due process analysis focuse[s] upon the activities of" the trustee in light of the beneficiary's residence, which is "relevant, but not dispositive." Pet. App. 24a–25a & n.2. Thus, not a single judge in the North Carolina system who reviewed this case agreed with the State's position.

The State sought certiorari limited to the "narrow question" of whether the challenged tax is justified based "solely on the presence of an in-state beneficiary." Pet. Rep. in Supp. of Cert. 6–7 ("[T]his case is an ideal vehicle: It presents the beneficiary's in-state residency in clean form, allowing the Court to resolve the question presented without the need to consider other types of jurisdictional contacts.").

SUMMARY OF ARGUMENT

North Carolina's exercise of jurisdiction over a nonresident trustee with no connection to the State, based solely on the fact that a contingent beneficiary lived there, violates the Due Process Clause.

I. This Court has twice addressed and decided the question presented, and those precedents control here.

A. As part of a series of decisions on the constitutional limits of trust taxation, this Court held that the State where a beneficiary resided could not, on that basis alone, tax a nonresident trustee on trust property the resident beneficiary neither received nor controlled. *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83 (1929). That decision rested on practical considerations of actual control and ownership, and it aligns with the principles of fundamental fairness that animate contemporary due process cases. The State's effort to dismiss *Safe Deposit* as based on the physical location of the taxed property mischaracterizes its reasoning and ignores its central place in a principled, practical, and fair framework for defining the outer bounds of state jurisdiction to tax trust property.

B. This Court reached the same conclusion in *Hanson v. Denckla*, 357 U.S. 235 (1958), a pillar of due process jurisprudence. In *Hanson*, the Court held that a State may not assert jurisdiction over a nonresident trustee based solely on the forum residence of beneficiaries. Focusing on the trustee's own actions, the Court articulated the requirement of "purposeful availment" that remains the constitutional touchstone. The Court specifically refused to attribute a beneficiary's forum contacts to the trustee, reasoning that "[t]he unilateral activity of those who claim some relationship with a nonresident . . . cannot satisfy the requirement of contact with the forum State." *Id.* at 253.

Hanson is not distinguishable in any material respect. There is no practical difference between asserting jurisdiction over the trust property and asserting jurisdiction over the trustee who owns the trust property. And state jurisdiction to tax is informed by the same principles governing jurisdiction to adjudicate. *Hanson*'s reasoning and result control this case, and unless this Court repudiates both, North Carolina cannot prevail here.

II. The due process principles elaborated in this Court's subsequent decisions confirm the holding of *Safe Deposit* and *Hanson* and invalidate the North Carolina tax.

A. Due process requires minimum contacts between the State and the taxpayer and a rational relationship between the tax and fiscal values connected to the State. *Quill*, 504 U.S. 298.

Under this Court's decisions, the focus of the minimum-contacts inquiry must be the taxpayer's own conduct. The State does not argue that the taxpayer engaged in any conduct by which he purposefully availed himself of North Carolina. Instead, the State supports jurisdiction solely by pointing to a different person's conduct—the decision of a contingent trust beneficiary to live there. That argument fails: a nonresident's relationship with a forum resident, without more, cannot establish the necessary minimum connection. Similarly, taxing the trustee for the worldwide income of the trust based on the possibility that a contingent beneficiary might someday receive it in North Carolina does not qualify as the rational fiscal relationship that *Quill* requires.

B. The State principally contends that the forum contacts of any one "trust constituent" are attributable to anyone else in the trust relationship, including the trustee. But this Court's precedent and the distinct roles of trustees and beneficiaries under basic tenets of trust law foreclose the State's effort to fuse them for jurisdictional purposes. And what the State decries as the "separateness theory" of trust constituents is a consequence of North Carolina's own law, which treats the trustee and beneficiary as independent actors who cannot bind one another.

C. Jurisdiction over the trustee cannot rest on the ground that the State provided public services to the beneficiary. This Court has previously rejected that argument, which, like the State's main theory, focuses on the wrong party and does not show that the *trustee* purposefully availed himself of the forum.

The argument also assumes facts that are not true. The State claims that the beneficiary consumed state resources without paying taxes in return, but in fact, she did pay taxes on all income she had actually received and enjoyed during the tax years. She had not received—and might never have received—income of a trust she did not control and did not know existed, and there is no basis to treat that income as if it were hers. Similarly, the State asserts that the protections it provided the beneficiary spared the trustee from having to furnish equivalent services. In truth, the trustee had no obligation to provide the beneficiary anything in the tax years other than the good-faith exercise of his absolute discretion.

The State's public-benefits argument is boundless. It would permit jurisdiction over the trustee not just

in any State where a contingent beneficiary resides, but also in any State that, because the beneficiary spent time there, could claim to have provided her the interim protections of its laws.

D. The existence of a fiduciary relationship with a forum resident does not create jurisdiction over the trustee wherever any beneficiary decides to move. This Court has repeatedly held that assuming a role with fiduciary obligations to a resident does not constitute purposeful availment. The circumstances of this case demonstrate why the State's argument is incorrect. The trustee and beneficiary were literal strangers for the first 15 years of the trust's existence, and their interactions thereafter were "very infrequent[.]" App. 127.

III. Misplaced policy concerns about the impact of the decision below on state tax revenues do not justify the State's jurisdictional overreach. Those concerns are greatly exaggerated. States have ample means of taxing trust income unaffected by the ruling below. States make individual decisions about whether to tax trust income within their jurisdiction, and those choices reflect considered judgments about tax policy. Limits on state jurisdiction are a consequence of federalism, which promotes and respects the sovereign right of each State to set its tax policy without interference from other States that lack a legitimate interest. North Carolina's jurisdiction does not expand because it disagrees with the policy choices of other States to refrain from exercising their constitutional power.

ARGUMENT

I. THIS COURT'S DECISIONS RESOLVE THIS CASE AND COMPEL THE HOLDING BELOW

This Court's decisions foreclose North Carolina's attempt to exercise jurisdiction over a taxpayer with no forum contacts. Cases decided specifically in the context of trust taxation have already addressed and rejected the State's position. And the foundational minimum-contacts case of *Hanson v. Denckla* confirms the correctness of the Court's previous decisions in the *International Shoe* framework.

A. *Safe Deposit* and Its Corollary Decisions Invalidate the North Carolina Tax

The Court has resolved the question presented as part of a series of decisions that establish common-sense and fair due process limits on trust taxation. Under those decisions, a State may tax a resident trustee for property he owns, and it may tax a resident beneficiary for property she receives or controls. A State may not, however, tax a nonresident trustee for no reason other than the residence in the State of a beneficiary who has not received and lacks possession or control of the trust property.

1. This Court has rejected the tax North Carolina imposed

In *Brooke v. City of Norfolk*, 277 U.S. 27 (1928), this Court considered whether a State may tax a resident beneficiary on the assets of an out-of-state trust. The trust was created by the will of a Maryland citizen conveying the trust property to a Maryland trustee for the benefit of the Virginia-resident petitioner and her descendants. The petitioner had paid Virginia "without question a tax

upon the income received by her," but she challenged Virginia's power to tax her for the undistributed Maryland trust property. *Id.* at 28.

The Court held the tax unconstitutional on the basis of fundamental principles of fairness. The premise of the attempted tax, the Court observed, was "that the petitioner is chargeable as if she owned the whole" trust, and not just the income she actually received. *Id.* Rejecting that premise, the Court contrasted the petitioner's situation with that of a taxpayer who "actually us[ed]" the property. *Id.* at 29. Here, the Court explained, "the property is not within the State, does not belong to the petitioner and is not within her possession or control. The assessment is a bare proposition to make the petitioner pay upon an interest to which she is a stranger. This cannot be done." *Id.*

One year later, the Court addressed the corollary question to *Brooke*, which is also the question presented in this case: If the State may not tax a resident beneficiary on undistributed out-of-state trust property, may the State tax an out-of-state trustee on the sole ground that the beneficiary is a resident? Considering the same realities of actual control and ownership underlying *Brooke*, the Court held that such a tax offends due process. *Safe Deposit*, 280 U.S. 83.

The trust property in *Safe Deposit* was held by a Maryland trustee for the benefit of the settlor's two Virginia-resident sons. Under the trust agreement, the trustee was to own the property until distribution of half of the assets to each son as he reached 25. Although neither son had yet received any distribu-

tions, Virginia taxed the Maryland trustee based on the fact of the beneficiaries' Virginia residence.

This Court invalidated the Virginia tax on the trustee as a violation of the Due Process Clause, focusing on the practical realities of the trust relationship. Under the doctrine that intangible property follows its owner, the Court reasoned, Virginia could as a general matter assert jurisdiction over trust property even though it was located outside the State's territorial borders. That general rule applied, however, only if it aligned with reality—only if, as the State contended, the beneficiaries "really owned the [trust] fund." *Id.* at 91.

In truth, the Court recognized, the State's argument "plainly conflict[ed] with fact"; the beneficiaries did not own the trust assets and "no person in Virginia ha[d] present right to their enjoyment or power to remove them." *Id.* at 92. Because "nobody within Virginia ha[d] present right to their control or possession, or to receive income therefrom, or to cause them to be brought physically within her borders," the Court held that Virginia lacked jurisdiction to tax the trust assets through the nonresident trustee. *Id.* at 91.

The Court distinguished previous cases that had permitted taxation by highlighting practical differences in true ownership and control. In those other cases, the Court reasoned, the resident had either "full power to control the deposits" or "control and present right to all benefits arising from the property"; "[t]he legal title was not held by another with the duty to retain possession, as in the present cause." *Id.* at 94. The Court thus concluded that taxation of a nonresident trustee based solely on the

forum residence of a beneficiary "would result in inescapable and patent injustice," violating the principles of fairness the Due Process Clause protects. *Id.* at 92.[3]

As this description illustrates, there is no merit to Petitioner's effort to dismiss *Safe Deposit* as beholden to a "rigid" *Pennoyer*–based rule of "physical presence." Pet. Br. 27–28. *Safe Deposit* relied on the same "traditional notions of fair play and substantial justice" that continue to animate due process jurisprudence. The Court did *not* reject Virginia's exercise of jurisdiction because the trust property was physically located outside of the State's border. Quite the contrary, the Court noted that it could—and ordinarily would—uphold jurisdiction based on the intangibles-follow-the-owner fiction even though the property was not physically present

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[3] The State seizes on references in *Safe Deposit* to "double taxation" in an effort to cast that decision as resting on outdated concerns. In fact, this Court had already held more than a decade before—in a case *Safe Deposit* specifically cited—that the Due Process Clause does not categorically forbid "double taxation." *See Fidelity & Columbia Tr. Co. v. City of Louisville*, 245 U.S. 54, 58 (1917) ("[L]iability to taxation in one State does not necessarily exclude liability in another.").

The Court's driving concern in *Safe Deposit* was instead that the attempted tax was "double and oppressive" because it would permit any State in which a beneficiary or trustee lived to tax the whole trust as a resident. That concern remains just as vital today and independently dooms the North Carolina tax under the Commerce Clause. *See Comptroller of the Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1795 (2015) (holding that the Constitution prohibits a state tax scheme that risks "double taxation of income earned out of the State" in a manner that disfavors interstate activity).

in the State. The Court rejected that fiction precisely because it "plainly conflict[ed] with fact": the beneficiaries did not really own the trust property, nor did they own, control, or actually receive any trust income.[4]

The State's characterization of *Safe Deposit*'s reasoning—that "once the Court decided that the trust property itself was not physically present in the State, the case was over"—is simply wrong. Pet. Br. at 27. In fact, the reasoning in *Safe Deposit* reflects the "highly realistic" approach that this Court has prescribed for due process inquiries. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 479 (1985).

2. *Safe Deposit* is part of a fair, principled, and practical due process framework

Brooke and *Safe Deposit* form part of a fairness-based framework for constitutional jurisdiction in the trust taxation context. Complementing those decisions, and completing the principles they established, is an additional pair of cases confirming that States may assert jurisdiction when doing so aligns with the reality of actual ownership and control of trust property.

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[4] Similarly, there is no merit to *amicus*' argument that the result in *Safe Deposit* and *Brooke* depended on the particular type of tax involved. *See* Brief for Tax Law Professors at 16–18. In both cases, the Court concluded that the tax was unconstitutional because it attributed to the beneficiaries ownership of intangible property that was not actually theirs, and to which they were "a stranger." *Brooke*, 277 U.S. at 29. That rationale has nothing to do with whether the tax is on principal or instead on income.

First, in *Guaranty Trust Co. v. Virginia*, 305 U.S. 19 (1938), the Court held that Virginia could tax a resident beneficiary on income she actually received from an out-of-state trust. *Id.* at 23; *see also Maguire v. Trefry*, 253 U.S. 12 (1920). Rejecting the beneficiary's Due Process Clause challenge, the Court relied on decisions upholding taxes imposed on income to those who actually "recei[ved] and enjoy[ed]" it. *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932) (permitting taxes on "the economic interest realized by the receipt of income or represented by the power to control it"); *New York ex. rel. Cohn v. Graves*, 300 U.S. 308, 312 (1937) (noting that the petitioner actually "received" the taxed funds "as a part of her income in the tax years").

Second, in *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947), the Court upheld a tax on a resident trustee for trust property he legally owned. Although the beneficiary, the other trustee, and the records were elsewhere, the Court again focused on ownership and control, reasoning that the State could tax the resident trustee because "the intangibles are subject to [his] immediate control" and the State "offer[s] benefit and protection through its law to the resident trustee as the owner of intangibles." *Id.* at 493, 496. The Court cited and specifically distinguished *Safe Deposit* on the ground that, in that case, the trust assets were "actually in the hands of the nonresident trustee and not subject to the control" of the resident beneficiary. *Id.* at 496.

The State relies heavily on *Greenough*, attempting to portray it as a repudiation of *Safe Deposit* and a fundamental shift in reasoning. This, too, is a

mischaracterization. *Greenough* did not endorse a nebulous inquiry permitting the State to blend "the contacts of people in the trust relationship," such that the jurisdictional contacts of any one person in that relationship can be attributed to any other. Pet. Br. 28. To the contrary, *Greenough* followed the same path marked by *Brooke*, *Safe Deposit*, and *Guaranty Trust*, focusing on the particular person whom the State sought to tax and evaluating whether the realities of *that* person's circumstances supported jurisdiction. That focus remains a central requirement of due process. *See infra* pp. 32–33; *Walden v. Fiore*, 571 U.S. 277, 284 (2014) (forum contacts must be those of the "defendant *himself*"). In *Greenough*, the Court upheld jurisdiction because the person with forum contacts owned and controlled the property; in *Safe Deposit*, there was no jurisdiction because the person with forum contacts did not own or control the property.

Greenough and *Safe Deposit* are in harmony with one another and with *Brooke* and *Guaranty Trust*. Together, they establish an analytical construct consistent with first principles of fairness. A State may tax a resident beneficiary on income that she actually receives or controls (*Guaranty Trust*), and a State may tax a resident trustee on trust income that he owns and controls (*Greenough*). But a State may not tax a resident beneficiary on out-of-state trust income that she neither actually receives nor controls (*Brooke*), and, absent some other jurisdictional basis, a State may not tax a nonresident trustee for trust income that a resident beneficiary neither actually receives nor controls (*Safe Deposit*).

This framework, and particularly the holding of *Safe Deposit*, compelled the conclusion of every court to consider this case. Here, as in *Safe Deposit*, the State sought to tax the trust based solely on the residence of a beneficiary. As in *Safe Deposit*, the State relied on the beneficiary's forum contacts by arguing that the resident beneficiary "really own[s]" the trust property. *Safe Deposit*, 280 U.S. at 91. Here, as there, that argument "plainly conflicts with fact"; neither the beneficiary nor anyone else "within [the taxing State] ha[d] present right to [the funds'] control or possession" or "present right to their enjoyment." *Id.* at 91–92. Thus, as in *Safe Deposit*, the North Carolina tax is "unjust and oppressive," an effort to confiscate property over which the State has no constitutional jurisdiction. *Id.* at 93; *see Miller Bros. Co. v. Maryland*, 347 U.S. 340, 342 (1954) ("[S]eizure of property by the State under pretext of taxation when there is no jurisdiction or power to tax is simple confiscation and a denial of due process of law.").

B. *Hanson v. Denckla* Confirms the *Safe Deposit* Result and Resolves this Case

The outcome in *Safe Deposit* is confirmed by *Hanson v. Denckla*, 357 U.S. 235 (1958). The issue in that canonical due process case was whether a State could exercise jurisdiction over a nonresident trustee based on, among other things, the fact that the trust beneficiaries resided there. The Court held that the beneficiaries' residence in the State did not supply the minimum contacts necessary to sustain jurisdiction over the trustee.

1. *Hanson* rejected jurisdiction over a trustee based on the residence of a beneficiary

Hanson concerned a trust agreement executed in Delaware between a Pennsylvania-domiciled settlor and a Delaware trustee. The trustee was to provide income for life to the settlor as a beneficiary, with the remainder to be paid to other beneficiaries that the settlor designated. The settlor later moved to Florida, where she executed a power of appointment naming certain beneficiaries.

After the settlor's death, two of her children sued in Florida state court challenging the validity of the appointment. The beneficiaries, who were Florida residents, appeared as defendants, but the nonresident Delaware trustee was not served and did not appear. The defendants moved to dismiss on the ground that jurisdiction over the Delaware trustee would violate the Due Process Clause. The Florida courts rejected that contention and held the appointment invalid.

This Court reversed on the ground that Florida lacked jurisdiction over the trustee. The Court began by noting that, "[a]s technological progress has increased the flow of commerce between States, the need for jurisdiction over nonresidents has undergone a similar increase." *Id.* at 250–51. Nevertheless, the Court cautioned, "it is a mistake to assume that this trend heralds the eventual demise of all restrictions" on constitutional jurisdiction, and, even under the "flexible standard of *International Shoe*," the Court concluded that the trustee was not within the State's power. *Id.* at 251.

Whether jurisdiction is proper, the Court explained, depends on the existence of "minimal

contacts" with the trustee "that are a prerequisite to [the State's] exercise of power." *Id.* (internal citations omitted). The Court "fail[ed] to find such contacts in the circumstances of this case": The trustee "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 that State." *Id.* In addition, the Court observed, the trust was created "without any connection with the forum State": "The agreement was executed in Delaware by a trust company incorporated in that State and a settlor domiciled in Pennsylvania. The first relationship Florida had to the agreement was years later when the settlor became domiciled there, and the trustee remitted the trust income to her in that State." *Id.* at 252.

Throughout the analysis, the Court trained its focus on the trustee's own actions and conduct, rejecting efforts to attribute to the trustee forum contacts of other parties to the trust relationship. Thus, the Court noted that while the settlor and life beneficiary "carried on several bits of trust administration" in Florida, "the record discloses no instance in which the *trustee* performed any acts in Florida" that would support jurisdiction. *Id.* (emphasis added).

The Court similarly rejected the contention that Florida acquired jurisdiction over the trustee because the settlor and life beneficiary exercised the power of appointment in that State. It was specifically in this context that the Court articulated what is now a hallmark principle of due process:

> The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State. The application of that rule will vary with the quality and nature of the defendant's activity, but it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. The settlor's execution in Florida of her power of appointment cannot remedy the absence of such an act in this case.

Id. at 253–54 (internal citation omitted).

Finally, the Court addressed directly the argument that jurisdiction over the Delaware trustee was proper "because the settlor and most of the appointees and beneficiaries were domiciled in Florida." *Id.* at 254; *see id.* at 258 (Black, J., dissenting) (contending that Florida had power over the trustee because "the primary beneficiaries also lived in that State"). Basing jurisdiction on the presence of a beneficiary, the Court concluded, "is a nonsequitur." *Id.* at 254. While that fact could empower Florida to adjudicate the rights of the resident parties, it did not create jurisdiction over a different, nonresident entity. The issue, the Court explained, is jurisdiction, "not choice of law," and the jurisdictional question "is resolved . . . by considering the acts of the trustee," not those of other parties. *Id.* at 253–54.

Like *Safe Deposit*, *Hanson* resolves this case. In *Hanson*, as here, the issue was the validity of jurisdiction over a trustee as owner of the trust property in dispute. Like the State in this case, the *Hanson* petitioners and the dissenting opinion argued that the fact of in-state beneficiaries supported jurisdiction. The Court's response to that argument—that jurisdiction must be based on "the acts of the trustee," not the "unilateral activity" of a different person in the trust relationship, *id.* at 253—is dispositive here.

2. *Hanson* is materially indistinguishable

The State attempts to distinguish *Hanson* on two grounds, neither of which has merit.

First, the State contends that *Hanson* does not apply because it addressed jurisdiction to adjudicate, rather than jurisdiction to tax. The same principles govern in both contexts. *International Shoe* itself addressed jurisdiction both to tax and to adjudicate, reasoning that the "activities which establish[ed] [the corporation's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." 326 U.S. at 321; *see id.* (concluding that minimum contacts gave the State "constitutional power to lay the tax and to subject appellant to a suit to recover it"). The very decision that the State describes as establishing the controlling test, *Quill Corp. v. North Dakota*, resolved the tax dispute there by relying on adjudicative jurisdiction cases. 504 U.S. at 307–08 (discussing *International Shoe*, *Shaffer v. Heitner*, and *Burger King*). The *Quill* Court "framed the relevant inquiry as whether" the taxpayer "had minimum contacts with the jurisdiction 'such that the [tax] does not offend traditional notions of fair

play and substantial justice.'" *Id.* at 307 (quoting *Int'l Shoe Co.*, 326 U.S. at 316).

The *Quill* Court's reliance on adjudicative jurisdiction cases was correct. "Jurisdiction is as necessary to valid legislative as to valid judicial action." *St. Louis v. Ferry Co.*, 78 U.S. (11 Wall.) 423, 430 (1870). The Due Process Clause "protect[s] a person against having the Government impose burdens upon him except in accordance with the valid laws of the land," *Giaccio v. Pennsylvania*, 382 U.S. 399, 403 (1966), and that principle "is no less true with respect to the power of a sovereign to resolve disputes through judicial process than with respect to the power of a sovereign to prescribe rules of conduct for those within its sphere." *J. McIntyre Machinery, Ltd. v. Nicastro*, 564 U.S. 873, 879 (2011) (plurality opinion). In both contexts, the minimum-contacts requirement ensures "fair warning that [a person's] activity may subject [him] to the jurisdiction of a foreign sovereign." *Quill*, 504 U.S. at 312 (citing *Shaffer*, 433 U.S. at 218 (Stevens, J., concurring)).

Thus, the "minimum connection" necessary for a State directly to demand money from a person under threat of criminal penalty does not meaningfully differ from the "minimum contacts" necessary for the State to require the person to defend against that demand. Indeed, this Court has used the formulations interchangeably. *E.g, South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080, 2091 (2018) (describing an earlier tax decision as holding that the taxpayer "lacked the requisite minimum contacts with the State required by the . . . Due Process Clause"). And this Court has routinely applied minimum-contacts concepts when addressing state power to tax. *E.g.*,

Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009) ("[A] nondomiciliary jurisdiction may constitutionally tax property . . . when the taxpayer avails itself of the substantial privilege of carrying on business in that jurisdiction.") (internal citation and quotation marks omitted).[5]

Second, Petitioner incorrectly contends that *Hanson* does not apply because it concerned jurisdiction over the trustee, rather than over the trust. Pet. Br. 24. This Court long ago dismissed as an "ancient form without substantial modern justification" the "fiction that assertion of jurisdiction over property is anything but an assertion of jurisdiction over the owner of the property." *Shaffer*, 433 U.S. at 212. In both this case and *Hanson*, the person over whom the State asserted jurisdiction is the trustee. That was so in *Hanson* because the trustee owned the assets in dispute. It is so here because the trustee owns the income the State seeks to tax.

That the trustee is the relevant party for jurisdictional purposes is also a consequence of the State's own law. North Carolina imposes an income tax on individuals and then separately, in the statute at issue, requires the trustee to pay tax on trust income. N.C. Gen. Stat. § 105-160.2 (2017) ("The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provi-

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[5] The State itself relies on adjudicative jurisdiction cases when it deems them helpful. Pet. Br. 45 (invoking the "modern analysis under the Due Process Clause" and citing *International Shoe*), 26 n.11 (relying on *Burger King*), 28 (relying on adjudicative jurisdiction cases to urge rejection of *Safe Deposit*).

sions of this Part."); N.C. Dep't of Rev., Form D-407A (2018) (directing that "the fiduciary must file" the return reflecting trust income).

In reality and under the law, there is thus no difference between asserting jurisdiction over the trustee as legal owner of the trust property and asserting jurisdiction over the "trust abstraction."[6] Relying on such a distinction represents the height of the "kind of formalism" that the State purports to disavow. Pet. Br. 25.

Hanson therefore controls here. That decision is a pillar of modern due process jurisprudence, its reasoning often recited and its result consistently reaffirmed.[7] Unless this Court repudiates both, North Carolina cannot prevail in this case.

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[6] Nor does the name of the party in the case caption make any difference. "[L]egal proceedings involving such traditional trusts are effectively brought by or against their trustees[.]" *Raymond Loubier Irrevocable Tr. v. Loubier*, 858 F.3d 719, 722 (2d Cir. 2017); *see also Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S Ct. 1012, 1016 (2016) ("Traditionally . . . legal proceedings involving a trust were brought by or against the trustees in their own name[,]" and the trustee is also the relevant party "if the trust, as an entity, [is] sued.").

[7] Since deciding *Hanson*, this Court has invoked it as a key authority in nearly every subsequent due process decision. *See, e.g.*, *Bristol-Myers Squibb Co. v. Superior Ct.*, 137 S. Ct. 1773, 1780 (2017); *Walden*, 571 U.S. at 284–85, 288; *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915, 924 (2011); *Nicastro*, 564 U.S. at 877, 880–82; *Asahi Metal Industry Co., Ltd. v. Superior Ct.*, 480 U.S. 102, 109–10 (1987); *Burger King*, 471 U.S. at 474; *Ins. Corp. of Ir., Ltd. v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 713–14 (1982); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 294–98 (1980);
(continued)

II. DUE PROCESS PRINCIPLES COMPEL THE DECISION BELOW AND REFUTE THE STATE'S JURISDICTIONAL THEORIES

The holdings of *Safe Deposit* and *Hanson* align with the core set of principles this Court has prescribed for evaluating the outer constitutional limits of state jurisdiction. The State agrees that the outcome here should turn on "'the traditional notions of fair play and substantial justice' that shape modern analysis under the Due Process Clause." Pet. Br. 45 (quoting *International Shoe*). But aside from invoking "[f]reeform notions of fundamental fairness divorced from traditional practice," *Nicastro*, 564 U.S. at 880, the State does not attempt—and even urges this Court to avoid—application of the concrete principles that define the modern due process framework. Pet. Br. 21 n.9. Those tenets defeat the State's jurisdictional theories.

A. The State Cannot Show the Minimum Connection or Rational Relationship Necessary to Assert Jurisdiction

For the State to satisfy the Due Process Clause, it must establish that there exist minimum contacts, a "minimum connection, between a state and the person, property or transaction it seeks to tax, and that the income attributed to the State for tax purposes [is] rationally related to [fiscal] values connected with the taxing State." *Quill*, 504 U.S. at

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Kulko v. Superior Ct., 436 U.S. 84, 92–101 (1978); *Shaffer*, 433 U.S. at 215–16.

306 (internal quotation marks and citations omitted).[8]

The North Carolina tax fails this standard. The State's attempt to assert jurisdiction over the trustee based on nothing more than the forum residence of a contingent beneficiary conflicts with settled law that directs the focus on the trustee's own conduct. And the State cannot tax the worldwide income of the trust on the mere speculation that a forum resident may someday receive it.

1. Jurisdiction depends on the contacts of the taxpayer with the State and cannot rest solely on the taxpayer's relationship with a forum resident

"The inquiry whether a forum State may assert . . . jurisdiction over a nonresident [taxpayer] focuses on the relationship" between the taxpayer and the State. *Walden*, 571 U.S. at 283–84 (quoting *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770, 775 (1984)) (internal quotation marks omitted). The State cannot establish jurisdiction by pointing to the forum contacts of other parties; "[r]ather, it is the [taxpayer's own] conduct that must form the necessary connection with the forum State that is the basis for its jurisdiction over him." *Id.* at 285.

The necessary relationship "must arise out of contacts that the [nonresident] *himself* creates with

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[8] The State mischaracterizes the constitutional test. It asserts that "the Trust has the burden of establishing two elements": that the State "lacks a minimum connection," and that the amount taxed is "not rationally related" to the taxing State. Pet. Br. 15. As the party asserting jurisdiction, the State must satisfy both parts of the *Quill* standard.

the forum State." *Id.* at 284 (citing *Burger King*, 471 U.S. at 475) (internal quotation marks omitted). On that basis, this Court has "consistently rejected attempts to satisfy the . . . minimum contacts inquiry by demonstrating contacts between [third parties] and the forum State." *Id.* at 284. The "unilateral activity of another party or a third person is not an appropriate consideration when determining whether a [nonresident] has sufficient contacts with a forum State to justify an assertion of jurisdiction." *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 417 (1984).

Nor can jurisdiction be based solely on "the [taxpayer's] contacts with persons who reside" in the forum State. *Walden*, 571 U.S. at 285. The taxpayer's "relationship with a . . . third party, standing alone, is an insufficient basis for jurisdiction." *Bristol-Myers*, 137 S. Ct. at 1781 (quoting *Walden*, 571 U.S. at 286).

The irreducible due process requirement remains the one *Hanson* established in the trust context: "[I]t is essential in each case that there be some act by which the [taxpayer] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." 357 U.S. at 253; *see Goodyear*, 564 U.S. at 924; *Burger King*, 471 U.S. at 474 ("[T]he constitutional touchstone remains whether the [individual] purposefully established 'minimum contacts' in the forum State.").

2. There are no minimum contacts between the trustee and North Carolina

These enduring principles control this case. The State sought to tax the trustee on income of trust

property he owns and controls. It designated him as the person required to pay the tax. *See supra* p. 9. The jurisdictional inquiry therefore focuses on whether the trustee *himself* has minimum contacts with North Carolina.

The trustee has no such minimum contacts here. He did not engage in any conduct "purposefully avail[ing] [him]self of the privilege of conducting activities within the forum state." *Hanson*, 357 U.S. at 253. The State does not even attempt to argue otherwise. Instead, the State cites a single fact as grounds for jurisdiction: that a contingent beneficiary happened to move to North Carolina. Pet. Rep. in Supp. of Cert. 6–7 (asserting that this case presents only the question whether jurisdiction is proper based "solely on the presence of an in-state beneficiary").

Under this Court's decisions, the question presented thus answers itself. "If the question is whether an individual's [relationship] with an out-of-state party *alone* can automatically establish sufficient minimum contacts in the other party's home forum, we believe the answer clearly is that it cannot." *Burger King*, 471 U.S. at 478. A different person "cannot be the only link between the [taxpayer] and the forum." *Walden*, 571 U.S. at 285.

"In short, when viewed through the proper lens—whether the [taxpayer's] actions connect him to the forum—[the trustee] formed no jurisdictionally relevant contacts with" North Carolina. *Walden*, 571 U.S. at 289. Because the trustee lacks "the 'minimal contacts' with that State that are a prerequisite to its exercise of power over him," *Hanson*, 357 U.S. at 251, North Carolina's "unacceptably grasping" attempt at

jurisdiction violates the Due Process Clause. *Daimler AG v. Bauman*, 571 U.S. 117, 138 (2014).

3. There is no rational relationship between the taxed income and North Carolina's fiscal values

The North Carolina tax also fails the *Quill* requirement that the "income attributed to the State for tax purposes" must be "rationally related to [fiscal] values connected with the taxing State." 504 U.S. at 306.

The State taxed the worldwide income of the trust property through the trustee. None of that income was earned in the State, and no one in North Carolina received or enjoyed it during the relevant tax years. The State did not give the trustee "anything for which it could ask return," nor did the taxed income "bear[] fiscal relation to protection, opportunities, and benefits given by the state." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). The sole basis for the State's attribution of every penny of income to North Carolina was the possibility that the contingent beneficiary might someday receive it in North Carolina. That speculative basis does not satisfy *Quill* or due process.

B. The Contacts of Any "Trust Constituent" Are Not Attributable to Everyone Else in the Trust Relationship

The State's principal theory for jurisdiction is that the forum contacts of a beneficiary are attributable to the trustee. According to the State, the contacts of any person in the trust relationship are effectively the contacts of "the trust," and those contacts therefore bind the other "trust constituents" for

jurisdictional purposes. Thus, in the State's view, any State that has contacts with any "trust constituent" may assert jurisdiction over all other people associated with the trust.

That contention is incorrect. It conflicts with basic features of trust law and the actual relationship between trustee and beneficiary, it conflicts with the way in which this Court has approached questions of jurisdiction in the trust context, and it conflicts with North Carolina's own law.

1. The beneficiary and trustee are not agents, and the beneficiary does not represent the trust property

The State's argument misconceives the distinct roles that trustees and beneficiaries occupy in a traditional trust. Those distinct roles preclude the State's effort to treat the beneficiary and trustee as one for jurisdictional purposes on the ground that both are "trust constituents."

The trustee, not the beneficiary, represents the trust property and bears its rights and obligations. He can bind the trust property and is liable for all obligations incurred during the administration of the trust, including third-party claims against the trust assets. Austin W. Scott, William F. Fratcher & Mark L. Ascher, Scott & Ascher on Trusts ("Scott & Ascher on Trusts") §§ 26.1, 26.4 (5th ed. 2007); *Greenough*, 331 U.S. at 494 n.19 ("As a trustee holds the estate . . . he is personally bound by the contracts he makes as trustee, even when designating himself as such."). For procedural purposes, the trustee's domicile is dispositive, *see Americold*, 136 S Ct. at 1016, and "legal proceedings involving such tradi-

tional trusts are effectively brought by or against their trustees[.]" *Loubier*, 858 F.3d at 722.

Consistent with this principle, the trustee is liable for taxes assessed on the trust and for failure to file returns or pay taxes. Unif. Tr. Code § 816 (2000); George Gleason Bogert et al., *The Law of Trusts and Trustees* § 265 (2018) ("The liability of the Trustee for failure to file a tax return or to make estimated tax payments is the same as that of an individual.")

But this relationship between the trustee and the trust property does not apply to beneficiaries. The trustee does not represent the beneficiary: the trustee is not the beneficiary's agent and has no power to subject the beneficiary to third party claims. Scott & Ascher on Trusts §27.1; *see also* Restatement (Third) of Trusts § 103 (Am. Law Inst. 2003). This is true even when the trustee enters into a contract in the proper performance of his duties and purports to bind the beneficiaries personally. Scott & Ascher on Trusts §27.1 (The trustee "has no authority to act on behalf of the beneficiaries personally and is not subject to their control.")

Similarly, the beneficiary cannot bind trust property that does not legally belong to her. Where, as here, the trust instrument conveys to the trustee absolute discretion over the disposition of the trust property, a transferee or creditor of a beneficiary cannot compel the trustee to make distributions. Restatement (Third) of Trusts § 60 (Am. Law Inst. 2003). The beneficiary's inability to bind the trustee is reinforced by the inclusion of a spendthrift provision like the one in the trust agreement here, prohibiting the beneficiary from assigning or otherwise attaching the trust assets. Art. 12, App.

70 (prohibiting "attachment, execution, garnishment, sequestration or other seizure under any legal, equitable or other process.")

As a result, the State's assertion that a beneficiary "is a trust's most important constituent" means nothing in this context. Pet. Br. 29. Each of the "trust constituents" serves a distinct role; the trust cannot exist until the settlor expresses his intent to create it, and the trust cannot operate without a trustee to administer it.[9] The relevant question, however, is not the "importance" of the "constituent," but instead whether the practical nature of the relationships justifies the State's assertion of power over one person based on the actions of another. Under basic principles of trust law, the beneficiary's role does not support attribution of her actions to the trustee.

2. This Court's decisions in the trust context focus on the contacts of the person over whom the State asserts jurisdiction

This Court does not amalgamate the contacts of all "trust constituents" when evaluating jurisdiction over a person who is part of a trust relationship. Instead, as discussed above, *supra* § II(A), this Court

[9] The beneficiary need not be ascertainable, or indeed in existence, at the time the trust is created. N.C. Gen. Stat. § 36C-4-409(1) (trust "without a definite or definitely ascertainable beneficiary" is valid); Scott & Ascher on Trusts §12.1. "Thus, for example, a trust can be created for the benefit of a child not born or conceived at the time of the creation of the trust, or for the benefit of a definite class of persons although the identity of the individuals comprising its membership is not ascertained or ascertainable at the time of the trust's creation." Restatement (Third) of Trusts, § 2 (Am. Law Inst. 2003).

has consistently focused on the particular person over whom the State seeks jurisdiction and decided whether that person's conduct gives rise to the necessary minimum connection. That is as true in the trust context as it is in due process jurisprudence generally.

Hanson exemplifies the proper analysis. There, the Court focused on the nonresident trustee and concluded that the trustee's own contacts did not support jurisdiction. The Court rejected an effort to attribute to the trustee the conduct of other parties in the trust relationship, emphasizing that "[t]he unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State." 357 U.S. at 253. The State's basic theory in this case—treating the "trust constituents" as if they were interchangeable agents of a single trust entity—is the opposite of *Hanson*'s reasoning.

The State incorrectly invokes two cases to support its theory. First, the State contends that *Greenough* "treated a trust and its constituents as inextricably intertwined," Pet. Br. 26, such that "a trust constituent's residency in a state connects the trust to the state." *Id.* at 30.

That is a misreading of *Greenough.* The issue in *Greenough* was not whether jurisdiction was proper because *any* "trust constituent" resided in the State. Rather, the question was whether jurisdiction was proper specifically because the resident was a *trustee*. The Court upheld jurisdiction because of the unique features of the trustee's role as "the owner of the intangibles." 331 U.S. at 493; *see id.* ("This close relationship between the intangibles and the *owner*

furnishes an adequate basis for the tax *on the owner* by the state of his residence . . . . The state of the *owner's* residence supplies the *owner* with the benefits and protection inherent in the existence of an organized government.") (emphases added).

Because the beneficiary is not the owner of the trust property, the reasoning of *Greenough* does not "appl[y] equally to this case." Pet. Br. 30. As discussed above, *supra* pp. 21–22, the Court in *Greenough* distinguished *Safe Deposit* on exactly that basis. *Greenough*, 331 U.S. at 496 (noting that *Safe Deposit* "held invalid a state's tax on a trust's intangibles" because the property was "actually in the hands of the nonresident trustee and not subject to the control" of the resident beneficiary).

Second, the State contends that *Stone v. White*, 301 U.S. 532 (1937), rejected the "separateness theory" under which the contacts of people in the trust relationship are evaluated individually. *Stone* did not involve jurisdiction and did not change this Court's understanding of trust law. That case addressed a trust that gave the beneficiary an absolute right to the income "at such times and in such amounts as she should deem best." *Id.* at 533. In that context, the Court upheld imposition on the trustees of a tax that the beneficiary should have paid because it was on income that had been distributed to her. Given the beneficiary's actual ownership of the trust income and absolute right to demand it, the Court reasoned that it need not "shut its eyes to the fact that in the realm of reality it was the beneficiary's money which paid the tax." *Id.* at

535. Nothing in *Stone* affects the jurisdictional principles relevant here.[10]

3. North Carolina law treats beneficiary and trustee as separate and distinct entities

Not only are trustees and beneficiaries treated as separate and distinct under settled trust law and this Court's precedents, but they are also treated as independent actors by North Carolina itself.

Consistent with trust law generally, North Carolina statutes carefully assign the trustee and beneficiary distinct roles. In addition to authority conferred by the terms of the trust, the trustee possesses "[a]ll powers over the trust property that an unmarried competent owner has over individually owned property," as well as any "other powers appropriate to achieve the proper investment, management, administration or distribution of the trust property." N.C. Gen. Stat. § 36C-8-815 (2017). The trustee is empowered to "enforce claims of the trust and to defend claims against the trust." N.C. Gen. Stat. § 36C-8-811 (2018). North Carolina law further permits the trustee, among other things, to invest trust property, borrow money, abandon or

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[10] The State also incorrectly describes *Americold*, asserting that "[b]ecause of the abstract nature of a trust," the Court held that a trust's citizenship is determined by its membership. Pet. Br. 23 n.10. The entity in *Americold* "call[ed] itself a trust," but the Court concluded that the entity actually had "little in common with [a] traditional" trust. 136 S. Ct. at 1016. "For a traditional trust" like the one here, the Court confirmed, the trustee's "citizenship is all that matters for diversity purposes." *Id.*; *see also Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 462 (1980) ("[T]rustees are real parties in interest for procedural purposes").

relinquish rights, change the character of the trust property, and, with respect to securities, "exercise the rights of an absolute owner." N.C. Gen. Stat. § 36C-8-816 (2018).

The beneficiary has no comparable rights or powers. In fact, the trustee need not even "inform[] any beneficiary in advance of transactions relating to trust property." N.C. Gen. Stat. § 36C-8-813(b)(1) (2018). The beneficiary of a discretionary trust like the one here cannot encumber or transfer her interest in the trust, and a "creditor or assignee of a beneficiary may not reach a discretionary trust interest or a distribution by the trustee before its receipt by the beneficiary." N.C. Gen. Stat. § 36C-5-504(b) (2018). The discretionary beneficiary's only concrete right is to sue for abuse of discretion in complying with a standard for distribution. N.C. Gen. Stat. § 36C-5-504(e) (2018).[11]

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[11] North Carolina follows the majority rule that its courts are the appropriate forum only for "a trust having its principal place of administration in this State." N.C. Gen. Stat. § 36C-2-202 (2018). *See also* Restatement (Second) of Conflict of Laws § 267 (Am. Law Inst. 1971); Scott & Ascher on Trusts, § 45.2.2.6. Indeed, North Carolina law specifically prohibits the State's courts from adjudicating disputes involving out-of-state trusts absent extraordinary circumstances. *See* N.C. Gen. Stat. § 36C-2-203(2) (2018) ("The clerk of court shall not, over the objection of a party, entertain proceedings under this section involving a trust having its principal place of administration in another state except" when, among other things, "the interest of justice otherwise would be seriously impaired."). Thus, unlike in *Greenough*, the tax cannot be justified by the benefit the State provides the trustee in the form of access to its courts. North Carolina courts would be presumptively closed to disputes between the trustee and fiduciary over this trust. *Cf. Greenough*, 331 U.S. at 495 ("There may be matters of trust

(continued)

The State's tax system reinforces that separation between beneficiary and trustee. North Carolina law imposes a tax on beneficiaries as individual taxpayers for the income actually distributed to them. It separately imposes on trustees a tax for the income of the trust property they represent. N.C. Gen. Stat. § 105-160.2 (2017) ("The fiduciary responsible for administering the estate or trust shall pay the tax" on trust income); *see Sabine v. Gill*, 51 S.E.2d 1, 4–5 (N.C. 1948) (concluding that, as a result of North Carolina tax statutes, "the distance here between the trustees and the beneficiary seems to be too great for the judiciary to close the gap by making them to all intents and purposes one," and that "[t]he trusteeship is far from a mere agency which might lend itself to the concept of constructive holding" for the beneficiary).

What the State calls the "separateness theory" is, therefore, the result of its own laws.[12]

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administration which can be litigated only in the courts of the state that is the seat of the trust.").

[12] North Carolina's statutes reflect "the tendency of modern law to treat trusts as distinct legal entities" akin to corporations. Restatement (Third) of Trusts § 2 (Am. Law. Inst. 2003), comment i; *see id.* at comment a (describing as "outmoded" the "concept that a trust is not an entity"); N.C. Gen. Stat. § 36C-1-103(12) (2018) (defining "person" to include a trust); N.C. Gen. Stat. § 58-1-5(9) (2018) (defining a trust as a "person" for insurance purposes).

This Court could thus affirm on the alternative ground that the State, having decided to treat trusts as corporate-like entities that are separate and distinct from trust beneficiaries, cannot then deny that separate status for jurisdictional purposes by arguing that the trust and its beneficiaries are effectively one and the same.

C. The State Cannot Assert Jurisdiction over the Trustee on the Basis of Public Services Provided to a Beneficiary

The State next contends that it may tax the trustee in exchange for the public services it provided to the resident beneficiary. Pet. Br. 30–36. That argument fails for three basic reasons.

First, it suffers from the same flaw as the State's principal theory, "improperly attribut[ing] [another person's] forum connections to the [taxpayer] and mak[ing] those connections decisive in the jurisdictional analysis." *Walden*, 571 U.S. at 289 (internal citation and quotation marks omitted). The State focuses on benefits provided to the beneficiary, but the State taxed the trustee, so the relevant question is what benefits the *trustee* received. The State posits indirect ways in which North Carolina helped the trustee because of his relationship with the beneficiary. But "financial benefits accruing . . . from a collateral relationship to the forum State will not support jurisdiction if they do not stem from a constitutionally cognizable contact with the State." *World-Wide Volkswagen*, 444 U.S. at 299. On that basis, the Court rejected in *Kulko* exactly the argument the State is now advancing. There, the Court addressed the contention that California's jurisdiction over a Florida parent was proper because of public benefits California had provided his minor child:

> The court below stated that the presence in California of appellant's daughter gave appellant the benefit of California's police and fire protection, its school system, its hospital services, its

> recreational facilities, its libraries and museums . . . . But, in the circumstances presented here, these services provided by the State were essentially benefits to the child, not the father, and in any event were not benefits that appellant purposefully sought for himself.

436 U.S. at 94 n.7 (internal quotation marks omitted). That reasoning is even more compelling in this case. *Kulko* involved a parent with mandatory support obligations to the resident, whereas the trustee here had no legal obligation to provide anything to the beneficiary during the relevant period. And in *Kulko*, the parent sent the resident to the forum State to live. The trustee here, in contrast, had no control over the beneficiary's choice of residence.

Second, the State's public-benefits argument rests on premises that are incorrect, factually and legally. The State claims unfairness in the beneficiary consuming state resources without paying for them. But the beneficiary did pay North Carolina tax on all income that she and her family had actually received in exchange for the "benefits and protections that come with residency in North Carolina." Pet. Br. 34. The beneficiary had not received, had no right to receive, and did not own or control any of the income on trust property during the tax years. Whether to distribute that income was left to "the Trustee's absolute discretion." Art. 1 § 1.1(a), App. 46. Indeed, the beneficiary may not ever have received any trust assets. *See supra* pp. 3–5. There is thus no basis for treating the income as if it were hers. *Cf. Sabine*, 51 S.E.2d at 5 (rejecting beneficiary's claimed deduction

for taxes paid by the trustee because, under North Carolina statutes, the property belonged to the trustee "and [became] hers only by distribution").

The State also misstates the record in arguing that the protections North Carolina provided the beneficiary "replaced services that the Trust otherwise would have had to buy" for her. Pet. Br. 34–35. In fact, the trustee was not required to provide any income or principal to the beneficiary during the years at issue. While the trust agreement highlighted certain life events as guidance to the trustee, Art. 1 § 1.4(c), App. 51, the decision whether to distribute income and principal remained the trustee's alone. *Id.* at 46–47. That decision could be challenged only if it were "arbitrary or the result of bad faith." *Supra* p. 5.

Third, there are no discernable limits to the theory that a State may premise jurisdiction over a trustee on public services to a beneficiary. That theory would not be limited to the beneficiary's residence. It would also permit taxation by any State that, because the beneficiary spent a meaningful amount of time there, could claim to have "give[n] the beneficiary the interim protection of its laws" and provided her valuable services. Pet. Br. 33 (internal quotation marks omitted); *cf. Walden*, 571 U.S. at 290 (rejecting respondent's theory as overbroad because it would support jurisdiction not only in the forum State but also "wherever else [a third party] might have traveled").

Nor would the State's theory be confined to the trust context. According to that theory, when a State provides benefits and protections to a person while property she may someday receive generates income

elsewhere, "it is only fair" to permit the State to "demand a return" by taxing the current property owner for that income. Pet. Br. 17. This reasoning would apply to a parent who resides in New York and executes a will that contemplates the eventual distribution of all his assets to his only child, who resides in North Carolina. The State could equally contend in those circumstances that "North Carolina offered [the child] wide-ranging protections and services" while "income accumulated for [her] benefit," Pet. Br. 17, and on that basis impose a tax directly on the New York parent's income. Even the State would presumably not endorse that unfair result.

D. A Fiduciary Relationship with a Forum Resident Does Not Constitute Purposeful Availment by the Trustee

The State argues that the fiduciary nature of the trust relationship necessarily creates constitutional jurisdiction over the trustee wherever a beneficiary decides to live. Pet. Br. 26 & n.11. This Court has twice rejected that contention, and this case demonstrates why it should do so again.

In *Shaffer v. Heitner*, the Court considered whether Delaware could exercise jurisdiction over nonresident corporate officers of a Delaware corporation. Both the dissent and the appellee contended that the officers' decision to accept their positions and thereby to assume fiduciary obligations to a Delaware resident provided sufficient "contacts, ties, or relations" with that State to support jurisdiction. *Id.* at 213–14 (internal quotation marks omitted). The dissent argued that the officers "voluntarily associated themselves with the State[,]

. . . invoking the benefits and protection of its laws, by entering into a long-term and fragile relationship with one of its" residents. *Id.* at 227–28 (Brennan, J., dissenting) (internal citation and quotation marks omitted). The Court disagreed, holding that the acceptance of fiduciary obligations to a forum resident does not constitute "purposeful[] avail[ment] of the privilege of conducting activities within the forum State." *Id.* at 216 (internal citation and quotation marks omitted).

Hanson, of course, stands for the same proposition in the trust context. The Court refused to uphold jurisdiction over a nonresident trustee despite the trustee's fiduciary obligations to the resident beneficiaries. There, too, the Court rejected the argument that jurisdiction was proper because the trustee had availed itself of the forum by "maintain[ing] business relations" with the settlor and beneficiary, *id.* at 259 (Black, J., dissenting), or because the "community of interest" between the trust constituents was "so close" as to deem them "in privity," *id.* at 263 (Douglas, J., dissenting).

The State attempts to analogize this case to *Burger King*, but that comparison is inapt. Pet. Br. 26 & n.11. The Court upheld jurisdiction there because the franchisee had "deliberately reached out . . . and negotiated with a Florida corporation," entered into a commercial contract governed by Florida law, and accepted the "exacting regulation" of his business by the Florida corporation. 471 U.S. at 479–80 (internal quotation marks omitted).

No such circumstances are present here. The trustee did not reach into North Carolina to initiate a relationship, he has no contractual relationship

with the beneficiary, the trust is not governed by North Carolina law, the trustee is not subject to control or regulation by any North Carolina party, and he owed the North Carolina beneficiary nothing other than the good-faith exercise of his absolute discretion. The beneficiary's decision to reside in North Carolina "was completely adventitious as far as [the trustee] was concerned." *Rush v. Savchuk*, 444 U.S. 320, 328–29 (1980). "He had no control over that decision," and he did not by accepting the settlor's appointment subject himself to jurisdiction "in any state to which a potential [beneficiary] might decide to move." *Id.* at 329.

This case illustrates the error in the State's argument. For the first 15 years of the trust's existence, the beneficiary did not know the trust existed, and she never met the initial trustee. *See supra* p. 7. Even after the beneficiary eventually learned of the trust, she interacted "very infrequently" with the trustee and met with him only twice, both times in New York. App. 106–07, 126. That is not the kind of relationship that, by its nature, is necessarily so "intensive" and "inextricably intertwined" that jurisdiction over the trustee must follow the beneficiary. Pet. Br. 26 & n.11.

III. NORTH CAROLINA DOES NOT ACQUIRE JURISDICTION BECAUSE IT DISAGREES WITH THE TAX POLICY OF OTHER STATES

The State attempts to justify its jurisdictional overreach by advancing a series of policy arguments centered on the concern that the decision below opened a "judicially created tax shelter." Those arguments are incorrect and vastly overstated; the States have ample means of taxing trust income.

The State's real complaint is not that States lack constitutional power to tax, but rather that some of the States that possess power to tax have chosen not to use it. That disagreement does not give North Carolina license to extend its jurisdiction beyond constitutional boundaries.

A. States Have Ample Means of Taxing Trust Income Undisturbed by the Decision Below

The premise of North Carolina's policy argument is that the decision below "lays waste to the states' taxing authority" because it deprives States of the ability to tax trust income. Pet. Br. 2. As the Brief for the American College of Trust and Estates Counsel ("ACTEC Br.") demonstrates, that is simply not the case. States tax trust income in many different ways that the decision below does not disrupt. *See* ACTEC Br. 12–19 (describing the numerous ways in which States tax trusts).

The various approaches the States have employed largely align with the same considerations of actual ownership, control, and receipt underlying this Court's decisions. Thus, States tax the income of a grantor trust—one where the settlor retains control or ownership of the property—to the resident settlor.[13] When the beneficiary actually receives distributions, the State of the beneficiary's residence

[13] Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 20.09 (2019). For the federal rule, *see* 26 U.S.C.A. § 676 (a) (1986) ("The grantor shall be treated as the owner of any portion of a trust . . . where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.")

collects taxes.[14] States also tax trust income to the extent it is sourced to property or activity occurring within that State.[15]

This case concerns accumulated trust income that the trustee does not distribute in a particular year. States may and do tax such income in several ways. North Carolina incorrectly asserts that the decision below means that "the only state that can tax trust income is the state where a trustee lives." Pet. Br. 17. To be sure, a State with a resident trustee may tax undistributed income each year it is generated.[16] So, too, may a State in which a trust is administered.[17] But the State where the beneficiary resides may also collect taxes on accumulated income that was not distributed in a given year in one of two ways. If the beneficiary has an absolute right to the income, the beneficiary's State of residence may tax her for it regardless whether the income was distributed.[18] If, as here, the beneficiary's interest is instead contingent, the State of the beneficiary's residence may, pursuant to a "throwback" tax regime, collect tax on accumulated income from

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[14] *See Lawrence*, 286 U.S. at 280–81 (noting the established principle that the State of residence may tax an individual on all actual income from whatever source derived).

[15] *See, e.g.*, Me. Stat. tit. 36, §§ 5163, 5175-A (2017); Mich. Comp. Laws § 206.110 (2018); R.I. Gen. Laws §§ 44-30-16, 44-30-35 (2018); *see also* ACTEC Br. 5 n.12.

[16] *See, e.g.*, Ariz. Rev. Stat. Ann. §§ 43-1301(1)(b)(5) (2019); Ark. Code Ann. § 26-51-203 (2019); Cal. Rev. & Tax. Code § 17742 (2019).

[17] *See, e.g.*, Colo. Rev. Stat. § 39-22-103(10) (2018); S.C. Code Ann. § 12-6-30(5) (2018). *See also* ACTEC Br. 10–11.

[18] *See* 26 U.S.C.A. §§ 671, 678(a) (1954).

distributions made in future years. In States with such a throwback tax, income that was not taxed in the year it was generated is taxed to the resident beneficiary if and when she actually receives it—not, as with North Carolina's tax, to the nonresident trustee based on speculation that the resident beneficiary someday *might* receive it.[19] *See* ACTEC Br. 15–19 (explaining the operation of the "throwback" tax).

Thus, the ruling below rejected a single, specific tactic that only North Carolina and two other States have even attempted: taxing a trustee with which the State has no connection, on income that has not been distributed, solely on the possibility that at some later point the income might be distributed to a resident contingent beneficiary.[20] The North

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[19] *See, e.g.*, 61 Pa. Code § 105.5(c) (2019); Cal. Rev. & Tax Code § 17745(b) (2019); N.Y. Tax Law § 612(b)(40) (2019).

[20] Only Tennessee and Georgia also have statutes taxing nonresident trustees for undistributed income solely on the ground that a contingent beneficiary resides in the State. Tenn. Code § 67-2-110(a) (2018); Ga. Code Ann. § 48-7-22(a)(1)(C) (2017). Tennessee, however, has voted to eliminate the income tax entirely as of January 1, 2021. *See* H.R. 534, 110th Gen. Assemb., Reg. Sess. (Tenn. 2017) (enacted). Practitioners disagree about whether Georgia law actually requires such a tax on nonresident trustees. *See* ACTEC Br. 11 n.11 (citing Ga. Comp. R. & Regs. 560-7-8- 35(1)(d)).

California imposes such a tax only if the resident beneficiary actually receives, or has a noncontingent right to receive, the income in a particular year. Cal. Rev. & Tax Code § 17742(a) (2019); Franchise Tax Board, TAM 2006-2002, p. 2 ("A resident beneficiary whose interest in a trust is subject to the sole and absolute discretion of the trustee holds [only] a contingent interest in the trust."), *available at*

(continued)

Carolina courts correctly concluded that this method did not respect constitutional limits on jurisdiction.

B. Differences in Tax Policy Are a Consequence of Federalism and Do Not Expand North Carolina's Jurisdiction

The myriad approaches to trust taxation reflect the different choices of voters in the various States. North Carolina's disagreement with those choices does not permit it to assert jurisdiction over persons with whom it lacks the requisite minimum contacts.

There is no dispute that the income of this trust was within the taxing power of multiple States. Whether and how the income was actually taxed turned on the tax laws of the particular States with jurisdiction—laws that reflect those States' considered policy choices. In light of those choices, North Carolina and its State *amici* cannot attribute the results to the judiciary. Connecticut joins the State *amici* despite the fact that, as the State of the trustee's residence, it could have taxed the very income at issue in this case but chose not to. The State of Washington joins, expressing "grave concern" about the revenue impacts of the decision below, despite the fact that it imposes no income tax at all on anyone. Brief for Minnesota *et al.*, at 1.

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https://www.ftb.ca.gov/law/Technical_Advice_Memorandums/2006/20060002.pdf.

The remaining statutes that North Carolina cites (Pet. Br. 6 n.1) require further connections with the taxing State and therefore do not implicate the question presented here: whether a State may tax a nonresident trustee based solely on the fact of a resident contingent beneficiary.

North Carolina itself has decided not to tax trust income on the ground that a trustee or other fiduciary, as opposed to a beneficiary, resides in the State. Nor does North Carolina tax on the ground that the trust is administered there. That choice, which aligns with the State's concerted efforts to court a thriving banking industry,[21] is within the State's "sovereign right to formulate tax policy," *id.* at 9, reflecting a judgment to forgo certain tax revenue in favor of other objectives.

But differences among state tax laws, and concomitant respect for the limits of state power, do not create and have never been considered a "judicially created tax shelter." Instead, they are critical features of federalism. Observing the constitutional boundaries of state jurisdiction furthers the States' prerogative to make individualized choices without interference from other States that lack a legitimate interest. *See Bristol-Myers*, 137 S. Ct. at 1780–81 ("The sovereignty of each State . . . implie[s] a limitation on the sovereignty of all its sister States."). Indeed, one of the key functions of the minimum-contacts principle is to ensure that States "do not reach out beyond the limits imposed on them by their status as coequal sovereigns in a federal system." *World-Wide Volkswagen*, 444 U.S. at 292.

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[21] *See Key Industries in North Carolina – Business & Financial Services*, North Carolina Dep't of Commerce (touting the State's "low tax burdens" as a prime reason "financial institutions flock to North Carolina"; citing as a "competitive advantage" that "NC is ranked No. 1 for lowest state and local tax burden in the United States") (last visited March 14, 2019), https://www.nccommerce.com/business/key-industries-north-carolina/business-financial-services.

The decision below does not "end the states' ability to adopt tax approaches" to address the concerns that North Carolina perceives. Pet. Br. 42. The States can and frequently do reconsider the decisions they have made in this context.[22]

North Carolina's true complaint is thus not about the lack of state power to tax, but instead about the decision of certain States not to exercise that power. This Court has refused to base jurisdiction on these sorts of differences among laws in non-forum States. *E.g.*, *Keeton*, 465 U.S. at 779 ("Whether Ohio's limitations period is six months or six years does not alter the jurisdictional calculus in New Hampshire"; that other States would apply different rules "has nothing to do with the contacts" that matter for jurisdictional purposes). North Carolina's policy disagreements with other States are similarly irrelevant to its constitutional jurisdiction. *See Greenough*, 331 U.S. at 490 ("Neither the expediency of the levy nor its economic effect on the economy of the taxing state is for our consideration.").[23]

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[22] Tennessee, for example, voted in 2017 to eliminate the income tax. *See supra* n.20. In 2010, Washington voters considered but defeated a ballot initiative imposing an income tax. *See* Sec'y of State, State of Wash., Initiative Measure No. 1098 (filed Apr. 27, 2010), *available at* https://www.sos.wa.gov/elections/initiatives/text/i1098.pdf. In 2006, the Florida legislature repealed an intangible personal property tax. H.B. 209, 2006 Leg., Reg. Sess. (Fla. 2006) (enacted). In 2002, Ohio adopted an income tax on trustees. H.R. 675, 124th Gen. Assemb., Reg. Sess. (Ohio 2002) (enacted).

[23] Equally misplaced is the State's concern that the decision below will motivate behavior intended to minimize state tax burdens. Only North Carolina and two other States currently impose the tax at issue, so its invalidation will have little

(continued)

C. *Wayfair* Is Not Relevant

North Carolina repeatedly invokes *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), but that case is not relevant here. *Wayfair*, a Commerce Clause decision, endorsed the minimum-contacts framework that both parties agree governs this case. *Wayfair* rejected a physical-presence rule that played no part in the decisions below because *Quill* long ago rejected that requirement in the due process context.

The Court overruled previous cases in *Wayfair* based on intervening "dramatic technological and social changes" reflected in e-commerce. *Id.* at 2095 (internal quotation marks omitted). Technological changes have not had the same impact on trust administration. At least since *Greenough*, this Court has recognized that trustees are not stationary or affixed to one State. 331 U.S. at 493 ("The trustee of today moves freely from state to state. The settlor's residence may be one state, the seat of a trust another state and the trustee or trustees may live in still another jurisdiction or may constantly change their residence."); *see Hanson*, 357 U.S. at 250–51

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practical effect. In any event, taxpayer decisions based on the differential impact among state laws are a consequence of federalism. That individuals routinely consider how they would fare under various State tax regimes has no relevance to North Carolina's jurisdiction, nor is it a "fairness" argument in the State's favor. "Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." *Comm'r v. Newman*, 159 F.2d 848, 850–851 (2d Cir. 1947) (Learned Hand, J., dissenting).

(rejecting jurisdiction over the trustee even while recognizing that "technological progress has increased the flow of commerce between States").

To the extent *Wayfair* has any application, it confirms the decision below. In *Wayfair*, South Dakota argued that a nonresident taxpayer's own forum-directed conduct created a sufficient nexus for the State to collect sales tax from resident customers. Here, in contrast, North Carolina seeks to assert jurisdiction over one party based entirely on the forum contacts of someone else. Thus, if there is any analogy to be drawn to *Wayfair*, it demonstrates the error of North Carolina's position, which is the equivalent of contending that the respondent in *Wayfair* could be taxed by every State in which any one of its beneficial shareholders resided, based solely on the fact of their residence. That argument fails under the most basic principles of due process.

CONCLUSION

Respondent respectfully submits that the judgment of the court below should be affirmed.

Respectfully submitted,

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March 18, 2019

No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF NORTH CAROLINA

BRIEF OF *AMICUS CURIAE* THE NEW YORK STATE BAR ASSOCIATION IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICUS CURIAE*

The New York State Bar Association ("NYSBA") is the largest voluntary state bar association in the United States, with more than 72,000 members.[1] NYSBA's members live and practice in every town, city and county in the State of New York, and its membership also includes non-resident lawyers around the nation and throughout the world.

NYSBA has 26 sections dedicated to discrete areas of the law, including the Trusts and Estates Law Section, which consists of more than 3,000 members. With the assistance of its sections, as well as more than 60 committees, NYSBA drafts and supports legislation, sponsors conferences, seminars and institutes, and makes policy recommendations to bodies including the United States Congress, the New York State Legislature, and the New York State Office of Court Administration.

NYSBA previously has submitted *amicus curiae* briefs to the Supreme Court of the United States. NYSBA respectfully submits this brief in support of respondent, the Kimberley Rice Kaestner 1992 Family Trust ("Respondent"), and to assist the Court concerning the practical and policy implications of this case for the

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1. NYSBA respectfully submits this brief, pursuant to the blanket-consent letters that the parties filed with the Court. Pursuant to Rule 37.6 of the Court's Rules, *amicus* affirms that no counsel for a party authored this brief, in whole or in part; that no such counsel or party has made a monetary contribution intended to fund the preparation or submission of this brief; and that no person other than *amicus* and its counsel made such a monetary contribution.

trusts and estates bar, as well as the grantors, trustees, and beneficiaries of trusts.

SUMMARY OF ARGUMENT

NYSBA respectfully submits this *amicus curiae* brief in support of Respondent. The court below correctly found that an out-of-state trust that did no business in North Carolina, had no assets in North Carolina, and distributed no income to anyone in North Carolina had no connection or substantial nexus with that state, which unconstitutionally taxed Respondent on its undistributed income. This accords with generally accepted trusts and estates law, which draws a distinction between a trust's trustee and its beneficiaries, and does not treat a trust as a vehicle to serve at the beneficiaries' behest.

With that in mind, NYSBA respectfully submits that North Carolina's argument that a beneficiary is "the central figure" in a trust is a mischaracterization of well-settled trusts and estates law. Pet. Br. at 2. Contrary to North Carolina's contention, the central figure in a trust is the trustee, who is the taxpayer, the fiduciary, and the owner of legal title in the trust's property. This distinction is all the more apparent here, where the trustee has absolute discretion to make (or not make) distributions, and the beneficiaries' rights are contingent upon that absolute discretion.

Given the nature and purpose of trusts, North Carolina's tax impermissibly violates the Due Process Clause of the Fourteenth Amendment to the United States Constitution, as well as the Commerce Clause contained in the Constitution, by taxing trustees who

have no relationship with North Carolina. The tax violates the Due Process Clause because it does not require that a trustee have the requisite "minimum connection" with the state, nor does it require the existence of a rational relationship between North Carolina and the income it seeks to tax. As to the Commerce Clause, the tax fails the four-part test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), as there is no nexus between Respondent and North Carolina, and the tax is neither internally consistent nor externally consistent. Hence, the decision below should be affirmed.

ARGUMENT

I. A Trust Is Separate and Distinct from Its Beneficiaries, and Should Be Treated as Such for Purposes of State Income Taxation of Undistributed Trust Income.

To justify the state income tax that it assessed against Respondent, North Carolina effectively argues that no legal distinction exists between a trust and its discretionary beneficiaries. North Carolina's contention flatly contradicts the governing trusts and estates law, which this Court should apply in rejecting North Carolina's position.

A trust "is a fiduciary relationship with respect to property, subjecting [the person] by whom the title to property is held, to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it." Restatement (Second) of Trusts § 2. The trust relationship has three essential requirements: (1) "an expression

of intent that property be held, at least in part, for the benefit of one other than the settlor;" (2) "at least one beneficiary for whom the property is to be administered by the trustee;" and (3) "an interest in property which is in existence or is ascertainable and is to be held for the benefit of the beneficiary." George T. Bogert, *Trusts* § 1 (6th ed. 1987) ("Bogert on Trusts"); *Brown v. Spohr*, 73 N.E. 14 (N.Y. 1904).

A trust may be created for any lawful purpose, N.Y. E.P.T.L. § 7-1.4, but the most common reason for establishing a trust is to separate the control of trust assets from its beneficiaries. Restatement (Second) of Trusts § 59, cmt. b. As a result, legal title to trust property vests in the trustee, not in a beneficiary. *Stephens v. Tipton*, 268 P. 1014, 1015 (Or. 1928). The bifurcation of legal and beneficial title to trust assets is fundamental to the very existence of a trust; for if legal and beneficial title are not separated (such that legal and beneficial title to trust property rest in the same individual or entity), no trust arises. *Id.*

Beneficiaries are not "owners" of trust assets in the common sense of the word. On the contrary, because a trustee is a fiduciary, and fiduciaries and beneficiaries are separate entities, *Abell v. Tait,* 30 F.2d 54, 55 (4th Cir. 1929) (citing, *e.g.*, *Merchants' Loan & Tr. Co. v. Smietanka*, 255 U.S. 509 (1921)), *cert. denied,* 279 U.S. 849 (1929), a trust beneficiary's interest in trust assets is "non-possessory." Bogert on Trusts, § 38.

A trustee has legal ownership of trust assets, at least until trust distributions are made. The trustee's legal ownership of trust assets typically carries with it the

power to sell trust assets, to invest trust property, and to collect the income earned on trust property. Bogert on Trusts, § 88. A beneficiary has no such powers. In fact, a beneficiary's rights with respect to trust property are derivative, not direct, and are subject to the possessory rights that a trustee has as to trust assets. *Western R.R. Co. v. Nolan*, 48 N.Y. 513, 518-19 (N.Y. 1872). For example, in order to assert a cause of action on behalf of a trust, the trustee, not a beneficiary, must commence an action, even though that action ultimately may inure to the beneficiary's benefit. *Noel v. Liberty Bank of Ark.*, No. 3:10-CV-00107, 2012 WL 13027498, at *8 (E.D. Ark. Nov. 27, 2012).

Given the foregoing, and the nature of the trustee-beneficiary relationship, it logically follows that a beneficiary's right to distribution of trust assets is subject to limitations. It is governed by the terms of the trust instrument, pursuant to which the trust is created. Bogert on Trusts, § 38. As memorialized in the trust instrument, the settlor's intentions are entitled to great latitude in fixing beneficiaries' interests in a trust, and not all trust beneficiaries are created equal. The trust instrument may direct that a beneficiary's equitable interest in trust assets is subject to a definite period of trust administration, or that the trust's administration shall continue indefinitely. *Id.*; Wis. Stat. § 700.16. Likewise, the trust instrument may provide that a trust beneficiary's interest is contingent or vested; is in trust income or principal; is subject to a condition precedent or subsequent; or is possessory or non-possessory. Bogert on Trusts, § 38.

A settlor may direct that a trustee make certain distributions to specific beneficiaries (whose rights

are "mandatory"), or may "authorize the trustee to do or refrain from doing a certain act, or use his [or her] judgment as to when or how a power should be used." Bogert on Trusts, § 89. Put another way, a settlor may vest the trustee with partial or absolute discretion to make trust distributions. *Id.* In general, a trustee's exercise of discretion in making trust distributions (or refraining from doing so) will only be disturbed, by courts or otherwise, upon a showing that the trustee did not act in good faith. *Id.*; *In re Harmon*, 900 N.Y.S.2d 761, 764 (N.Y. App. Div. 2010). The trustee's exercise of discretion in distributing trust assets is entitled to tremendous deference, regardless of the wishes of trust beneficiaries (and, oftentimes, much to beneficiaries' chagrin). *Id.*

Further demonstrating the dichotomy that exists between trusts and their beneficiaries is the fact that courts typically will not require trustees to exercise their discretion to make trust distributions in a manner that would allow for beneficiaries' creditors and assignees to gain access to trust assets. *Lineback by Hutchens v. Stout*, 339 S.E.2d 103, 106 (N.C. Ct. App. 1986). Indeed, courts have explained that, under a "discretionary trust, the trustee may withhold the trust income and principal altogether from the beneficiary and the beneficiary, as well as the creditors and assignees of the beneficiary, cannot compel the trustee to pay over any part of the trust funds." *Id.*

In order to justify the unconstitutional state income tax that it seeks to levy against Respondent, North Carolina argues that a beneficiary is "the central figure in a trust." Pet. Br. at 2. North Carolina's contention overlooks well-settled trust law, which establishes that

three figures are essential to a trust: the settlor, the trustee, and the beneficiaries. The trust's beneficiaries are not, as North Carolina argues, more important to the trustee-beneficiary relationship than the trustee.

In fact, for the purpose of determining the legal ownership of assets that are held in trust, the beneficiaries are less important to the trust relationship than the trustee is. During the relevant tax years, the beneficiaries' ability to receive income distributions was subject to the trustee's absolute discretion. Joint Appendix ["App."] 45-47. As he was permitted to do under the terms of Respondent trust, the trustee did not exercise his discretion to distribute income to the beneficiaries during the 2005, 2006, 2007, or 2008 tax years. *Id.* at 12.

Legal title to trust assets, including its income, remained with the trustee, rather than the trust's beneficiaries. Because legal title to the trust's income remained with the trustee, and the beneficiaries had neither access to, nor control over the income, the trust and its beneficiaries are separate and distinct from each other, and should be treated as such for purposes of state income taxation of undistributed trust income.

Accordingly, it strains credulity to dispute that the trust was separate and distinct from its beneficiaries, and North Carolina's contentions to the contrary are devoid of merit.

II. Due Process Does Not Permit a State to Tax Undistributed Trust Income Based Solely on the Residence of a Discretionary Trust Beneficiary in the State.

The Question Presented addresses the extent to which the Due Process Clause permits North Carolina to tax undistributed income earned by a trust that is administered, and maintains all of its assets, books, and records, outside of North Carolina, based solely upon the North Carolina residence of discretionary trust beneficiaries to whom no trust distributions were made during the relevant tax years. As the Due Process Clause does not permit such state income taxation, the Court should affirm the decision of the court below.

Under the Due Process Clause, "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law[.]" U.S. Const. amend. XIV, § 1. The Court has interpreted the Due Process Clause to limit states' authority to tax, requiring a state to satisfy two jurisdictional prerequisites in order to impose tax on a prospective taxpayer. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992), *overruled in part by South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018). First, a state must show a "definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax". *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). Second, the state must establish the existence of a rational relationship between income that the state seeks to tax and "values connected with the taxing [s]tate." *Quill*, 504 U.S. at 306; *F.W. Woolworth Co. v. New Mexico*, 458 U.S. 354, 365 (1982). Absent those two jurisdictional prerequisites, a state cannot tax a

prospective taxpayer in a manner that passes Due Process Clause-based muster.

Although a state may, at times, tax a prospective taxpayer that does not have a physical presence within the state's borders in a constitutionally-permissible manner, the state's authority to do so is subject to limitations. *Oklahoma Tax Comm'n v. Chicksaw Nation*, 515 U.S. 450, 463 n.11 (1995). One such limitation is the requirement that the prospective taxpayer "purposefully avail . . . itself of the benefits of an economic market in the forum [s]tate." *Quill*, 504 U.S. at 307. The underlying rationale is that a prospective taxpayer's purposeful availment puts the prospective taxpayer on notice that its "activity may subject [it] to the jurisdiction of a" state in which it does not have a physical presence. *Id.* at 308. The foregoing principles apply regardless of whether (a) the prospective taxpayer is an individual, a business entity, or a trust, or (b) the tax concerns income or sales tax.

In order for a state to tax income earned by a trust in a manner that comports with the Due Process Clause, the state must establish that the trust has a "definite link" and "minimum connection" to the state, and that a rational relationship exists between the trust income that the state seeks to tax and the values that the state provides. *Linn v. Ill. Dep't of Revenue*, 2 N.E.3d 1203, 1208 (Ill. App. Ct. 2013); *Residuary Tr. A v. Dir., Div. of Taxation*, 27 N.J. Tax 68, 72-76 (N.J. Tax Ct. 2013), *aff'd*, 28 N.J. Tax 541 (N.J. App. Div. 2015) (affirming on the basis of statutory construction, rather than the Due Process Clause). Failing such a showing, the Due Process Clause will bar state income taxation of a trust. *Linn*, 2 N.E.3d at 1208; *Fielding v. Comm'r of Revenue*, 916

N.W.2d 323, 329 (Minn. 2018), *petition for cert. pending*, No. 18-664 (filed Nov. 15, 2018).

A. A Discretionary Trust Beneficiary's Residence In a State Does Not Justify That State's Taxation of Undistributed Trust Income That Is Earned In Another State.

A state's taxation of undistributed income earned by a trust that is administered in another state, based solely on the presence of a trust beneficiary within the taxing state, is hardly a novel concept. *Brooke v. City of Norfolk*, 277 U.S. 27, 28-29 (1928). In fact, for the past 80 years, this Court has rejected states' efforts to tax undistributed trust income earned in another state where the taxing state's sole connection to the trust is the residence of a trust beneficiary in that state. *Id.*; *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83, 92 (1929). The Court has reasoned that a trust and its beneficiaries, though related, are not one and the same. *Safe Deposit*, 280 U.S. at 92 (explaining that, where the trustee of a trust owned legal title to trust securities in Maryland, and none of the trust beneficiaries located in Virginia had a "present right to their enjoyment or power to remove them," the "securities did not and could not follow any person domiciled in Virginia"); *cf. United States v. One Parcel of Prop. Located at Route 27, Box 411 (Patterson Road), Montgomery Cnty., Alabama*, 845 F. Supp. 820, 823-24 (M.D. Ala. 1993) (in rejecting the federal government's argument that a trust beneficiary's knowledge should be imputed to the trust's trustee in a forfeiture proceeding concerning the beneficiary, the court noted that a trustee's ownership of trust property "is independent of the beneficiary," and oftentimes requires the trustee to protect "the beneficiary from his or her own improvidence or incapacity").

Relying upon this Court's well-reasoned precedent, other courts (including state courts) have held that, under the Due Process Clause, the presence of a trust beneficiary in a particular state, without more, is insufficient to establish minimum contacts to justify the state's taxation of undistributed trust income that is earned in another state. *Mercantile-Safe Deposit & Tr. Co. v. Murphy*, 242 N.Y.S.2d 26, 28 (N.Y. App. Div. 1963) ("We find no merit . . . in their thesis that since the resident beneficiaries of the trust could be taxed on income distributed the nonresident trustee can be taxed on income accumulated."), *aff'd*, 203 N.E.2d 490, 491 (N.Y. 1964). For example, in *Mercantile-Safe Deposit & Trust Co. v. Murphy*, New York sought to tax the undistributed income earned by a trust administered in Maryland, by a corporate trustee based in Maryland, solely because a trust beneficiary resided in New York. *Id.* Citing to *Safe Deposit*, New York's Appellate Division and Court of Appeals rejected the state's argument, and held that regardless of the beneficiary's residence in New York, the tax violated the Due Process Clause. *Id.*[2]

A similar result is warranted when a state's only connection to a trust is a discretionary trust beneficiary's

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2. The holding the New York courts reached in *Mercantile-Safe Deposit & Trust Co.* is consistent with the one that this Court articulated in *Hanson v. Denckla*. In *Hanson*, this Court found that the presence of trust beneficiaries in Florida did not confer on that state jurisdiction over the trustee of a trust who had no other Florida connections. *Hanson v. Denckla*, 357 U.S. 235, 254 (1958). While North Carolina argues that *Hanson* has no application here because personal jurisdiction in litigation and tax jurisdiction are distinct concepts, this Court has recognized that adjudicative jurisdiction and tax jurisdiction are comparable with each other. *Quill*, 504 U.S. at 307-08.

residence within the state. Under such circumstances, insufficient contacts exist between the state and the trust to justify the state's taxation of the trust's undistributed income. *Potter v. Taxation Div. Dir.*, 5 N.J. Tax. 399, 405 (N.J. Tax Ct. 1983). This is because the discretionary trust beneficiary has "no right to the undistributed trust income." *Id.* Absent an exercise of discretion by the trustee, the discretionary trust beneficiary cannot access such undistributed trust income, direct that it be paid to (or for the benefit of) the beneficiary, or otherwise exercise control over it. Restatement (Second) of Trusts § 128, cmt. d.; *but cf. Linser v. Office of Attorney Gen.*, 672 N.W.2d 643, 646 (N.D. 2003) (explaining that a discretionary beneficiary's interests in a trust are too remote to warrant treating the trust's undistributed assets as belonging to the beneficiary).

Recognizing that the presence of discretionary trust beneficiaries within North Carolina was the only connection that the trust had to that state, the court below correctly concluded that the trust lacked sufficient minimum contacts with North Carolina to justify its tax on all of the income the trust earned during the 2005 to 2008 tax years. *Kimberly Rice Kaestner 1992 Family Tr. v. North Carolina*, 814 S.E.2d 43, 51 (N.C. 2018). The trustee resided in Connecticut. App. 40-41. The trustee maintained the trust's books and records in New York. *Id.* at 41. All of the trust's assets were in Massachusetts. *Id.* The trustee did not make distributions to any beneficiaries that were located in North Carolina, earn income within that state, or otherwise transact business in North Carolina. *Id.* at 41-42.

Simply put, since neither the trust nor the trustee engaged in any affairs in North Carolina, it cannot be said that Respondent purposefully availed itself of any benefits associated with North Carolina. What is more, because the trust's discretionary beneficiaries did not have a right to access or control the trust's assets or income, and those beneficiaries did not receive any trust distributions during the relevant tax years, the mere presence of Respondent's discretionary beneficiaries in North Carolina during those years is insufficient to establish the requisite minimum contacts to justify that state's tax on Respondent's undistributed trust income during the relevant tax years.

Putting aside, for argument's sake only, that the mere presence of a discretionary beneficiary of a trust in a particular state is insufficient to establish minimum contacts to justify that state's taxation of undistributed trust income that is earned outside of the state, such undistributed trust income also bears no relationship, rational or otherwise, to the values that the state in which the discretionary trust beneficiary resides provides to the trust. *Blue v. Dep't of Treasury*, 462 N.W.2d 762, 764 (Mich. Ct. App. 1990). Since none of the trustee, the trust's assets or the trust's income is located within North Carolina, the state provides "no ongoing protection or benefit to the trust." *Id.* The state is essentially a stranger to the trust, regardless of the state's relationship to a discretionary trust beneficiary. *Cf. Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992) (noting that, to satisfy the Due Process Clause, "there must be a connection to the activity itself, rather than a connection only to the actor the [s]tate seeks to tax"). Consequently, the Due Process Clause does not permit North Carolina to tax the trust on undistributed income that the trust earned outside of North Carolina's borders.

North Carolina's reliance upon *Greenough v. Tax Assessors of City of Newport* for the proposition that "a trust constituent's residency in a state connects the trust to the state" is misplaced. Pet. Br. at 30. Although *Greenough* established that a state could constitutionally tax income earned by a trust based upon a trustee's presence within that state, *Greenough* does not support North Carolina's argument that a beneficiary's presence within the state provides the same jurisdictional basis. *Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486, 493-96 (1947).

North Carolina's claim that *Greenough* is at odds with *Safe Deposit* is incorrect. First, it is worthy of note that the Court cited to *Safe Deposit* in *Greenough*, recognizing that the two cases involved different jurisdictional issues. *Greenough*, 331 U.S. at 496-97. On the one hand, the Court answered the jurisdictional question in *Safe Deposit* – whether the presence of trust beneficiaries in Virginia permitted that state to tax the trust's assets, even though the trustee, and the trust's assets, were located in Maryland – in the negative. *Safe Deposit*, 280 U.S. at 89-94. On the other hand, however, the Court answered the jurisdictional question in *Greenough* – whether the presence of a trust's trustee in Rhode Island authorized that state to tax the trust's intangible assets – affirmatively. *Greenough*, 331 U.S. at 488-98. Collectively, they provide that the presence within a state of a trust's trustee, but not a trust's beneficiary, is sufficient to establish minimum contacts with the state. Hence, *Safe Deposit* and *Greenough* are consistent with each other.

Finally, Petitioner's reference to *District of Columbia v. Chase Manhattan Bank*, *Chase Manhattan Bank*

v. Gavin, and *McCulloch v. Franchise Tax Board* is misplaced. All but one of the trusts in question in *District of Columbia* and *Gavin* were testamentary trusts, which were created pursuant to decrees that issued from courts in the jurisdictions that imposed tax. *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539, 545 (D.C. 1997); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 795-99 (Conn. 1999). Although *Gavin* also concerned an inter vivos trust, the beneficiary thereof – whose presence in Connecticut was found to justify that state's taxation of the trust's undistributed income – had more significant vested rights in the *Gavin* inter vivos trust (including the right to receive the trust's corpus at age forty-five, and to direct how the trust's corpus would be distributed, if she died before attaining forty-five years of age) than Respondent's discretionary beneficiaries did in the trust established for their benefit. *Gavin*, 733 A.2d at 802. In *McCulloch*, California taxed the California-resident beneficiary of a Missouri testamentary trust for income earned during the last five years of the trust's administration, at a point when the trust already had terminated and its assets had been distributed to the beneficiary, which is readily-distinguishable from the present matter (in which Respondent's assets remained in trust during, and after, the relevant tax years). *McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 414-21 (Cal. 1964).

In light of the foregoing, the Due Process Clause does not permit a state to tax the undistributed income that a trust earns in another state, based solely upon the presence of a discretionary trust beneficiary within the taxing state. The court below correctly concluded as much in ruling for Respondent.

B. The Analysis of the Court Below Is Neither Formalistic Nor Rigid and Comports With the Due Process Clause.

Since deciding *International Shoe Co. v. Washington*, the Court has eschewed formalistic Due Process Clause tests that "focused on a [party's] 'presence' within a [s]tate in favor of a more flexible inquiry into whether [the party's] contacts with [a state] made it reasonable, in the context of our federal system of Government," to be taxed by the state. *Quill*, 504 U.S. at 307. Regardless of that flexibility, however, the Court has declined to abandon "the requirement that, in the case of a tax on activity, there must be a connection to the activity itself . . . " *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992). The Court has recognized that the Due Process Clause requires a connection to the activity that is taxed, not merely "to the actor [that] the [s]tate seeks to tax." *Id.*

North Carolina and certain *amici* assert that the North Carolina Supreme Court's holding was overly formalistic and rigid, in a manner that contravenes this Court's Due Process Clause precedents. Pet. Br. at 21-22; Br. for Minnesota and Nineteen Other States and the District of Columbia as Amicus Curiae Supporting Petitioner (hereinafter, the "States Amicus Br.") at 3-6. However, that argument fails because the income tax that North Carolina seeks to impose upon the trust's undistributed income bears no connection to activities that took place, or income earned, within North Carolina's borders. In effect, North Carolina impermissibly seeks to tax the trust based upon a connection not to the trust or the trustee, but rather to its beneficiaries, whose rights to access trust assets during the relevant tax years were subject to the trustee's absolute discretion. App. 42.

Minnesota, nineteen other states, and the District of Columbia advocate for the Court to adopt the Missouri Supreme Court's six-pronged test for determining whether a state can tax income earned by a trust. States Amicus Br. at 4. The six factors enumerated by the Missouri Supreme Court are: (1) "the domicile of the settlor"; (2) "the state in which the trust is created"; (3) "the location of the trust property"; (4) "the domicile of the beneficiaries"; (5) "the domicile of the trustees"; and (6) "the location of the administration of the trust." *Westfall v. Dir. of Revenue*, 812 S.W.2d 513, 514 (Mo. 1991). Under that test, when only one or two of the six factors are satisfied, the Due Process Clause cannot be met. *In re Swift*, 727 S.W.2d 880, 882 (Mo. 1987) (finding that Missouri could not impose income tax against a trust, even though the trust's settlor was domiciled in that state, and the trust was created there).

The test for which *amicus* advocates would not justify reversal here. Without more, the mere presence of a discretionary trust beneficiary in a particular state is insufficient to satisfy the Due Process Clause's requirement that a state have minimum contacts with a trust before taxing the trust's undistributed income. The presence of a trust beneficiary in a state is neither the dispositive factor that North Carolina claims it to be, nor one that warrants reversal here.

Contrary to the claims of North Carolina and certain *amici*, the North Carolina Supreme Court did not apply an antiquated, formalistic, or rigid Due Process Clause test in this matter. On the contrary, the court below properly recognized that North Carolina's efforts to tax undistributed trust income based solely upon the presence of discretionary trust beneficiaries within its borders

did not satisfy the Due Process Clause's requirement for minimum contacts.

C. The Court Below Did Not Create A Tax Shelter.

The states have adopted divergent approaches for taxing trust income. Seven states (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) do not tax trust income at all. Kevin R. Ghassomian, *Eliminate State Tax On Trust Income: A Comprehensive Update on Planning with Incomplete Gift Non-Grantor Trusts*, 39 ACTEC L.J. 317, 322 (Winter 2013). Although the remaining forty-three states and the District of Columbia do tax trust income, those jurisdictions apply different criteria in taxing income accumulated by trusts.

Only four states (California, Georgia, North Carolina, and Tennessee) tax income earned by trusts based upon the residence of a trust beneficiary within their borders. Cal. Rev. & Tax Code § 17742(a); Ga. St. § 48-7-22(a)(1)(c); N.C. Gen. St. § 105-160.2.; Tenn. Code Ann. § 67-2-110(a). Among the states in that small minority, Tennessee has repealed its state income tax, which will be fully phased out effective January 1, 2021. Tenn. Dep't of Rev., *2018 Guidance for Tennessee's Hall Income Tax Return* (July 12, 2017).

While the states are free to enact tax legislation of their choosing, that power is subject to limitations. *Greenough*, 331 U.S. at 493-95 ("But our question here is whether or not a provision of the Constitution forbids the tax. Neither the expediency of the levy nor its economic effect on the economy of the taxing state is for our consideration."). At the very least, the states must

comport with the Due Process Clause in enacting taxation legislation, which North Carolina failed to do here.

The Due Process Clause provides states with a wide array of options that do not raise constitutional concerns. Those options include: (1) taxing trust income that is derived from property and activity that takes place within a state; and (2) imposing tax on undistributed trust income earned by a trustee who is located in a state. Mich. Comp. Laws § 206.110; Ark. Code Ann. § 26-51-203(a)(1).

Yet another constitutionally-permissible option is available to states. States may tax accumulated trust income at the time that it is distributed to beneficiaries who are located within their borders, regardless of where the income is earned. N.Y. Tax Law § 612(b)(40); Cal. Rev. & Tax Code § 17745(b). When doing so, states receive the benefit of taxing resident trust beneficiaries, who receive trust distributions, for the accumulated income that the trusts earn during the years before distributions occur. Regardless of the contacts (or lack thereof) that the states have to trusts that are administered outside of their borders, states possess the minimum required contacts with trust beneficiaries who reside in the states and can tax such trust beneficiaries on accumulated trust income that is distributed to them without violating the Due Process Clause.

In light of the alternatives that are available to the states, it strains credulity to suggest that the analysis of the court below creates a tax shelter. Instead, as the North Carolina Supreme Court correctly recognized, a state can tax trust income, so long as the state satisfies the Due Process Clause's minimum contacts-based test,

which can be met by establishing that the trust's income arose from property or activities that occurred within the state, the trust's trustee was located in the state, or the trust's income was distributed to trust beneficiaries who resided within the state. Absent such a minimal showing, a state's taxation of trust income violates the Due Process Clause.

The Court's Commerce Clause-based analysis in *South Dakota v. Wayfair, Inc.* does not compel a contrary result. In *Wayfair*, the Court rejected the efforts of businesses that maintained no physical presence in particular states, but sold their goods and services to consumers located in those states via the internet, to avoid paying any sales tax to those states. In stark contrast to *Wayfair*, none of the parties to this proceeding argues that undistributed trust income is absolutely exempt from state income taxation in the absence of a physical presence of a trust within a state.

Rather, to the extent that a state's only connection with an out-of-state trust is a discretionary beneficiary's residence within the state, the state must await the beneficiary's receipt of trust distributions in order to tax trust income. Such a result fairly balances the state's interest in maximizing its tax revenues and the Due Process Clause's minimum-contacts analysis, by which all states are bound.

In light of the foregoing, North Carolina's tax on Respondent during the 2005 to 2008 tax years, which was predicated upon the residence of Respondent's discretionary trust beneficiaries in that state, violates the Due Process Clause. The Court should, therefore, affirm the North Carolina Supreme Court's decision.

III. North Carolina's Tax Violates the Commerce Clause.

Although the Question Presented concerns whether North Carolina's tax violates the Due Process Clause, Respondent argued below that the tax also violates the Commerce Clause. *Kimberly Rice Kaestner Family Trust v. North Carolina Dep't of Revenue*, 12-CVS-8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018). While the North Carolina Business Court ruled that the law violated both the Due Process Clause and the Commerce Clause, North Carolina's Court of Appeals and Supreme Court only ruled that the statute violated the Due Process Clause. *Id.*, 814 S.E.2d at 47. Should the Court consider North Carolina's tax vis-à-vis the Commerce Clause, it should find that it is unconstitutional, or in the alternative, remand the matter.

A. The Four Factors For the Dormant Commerce Clause Analysis Cannot Be Met.

A state tax will survive scrutiny under the Dormant Commerce Clause so long as it: "(1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides." *South Dakota v. Wayfair*, 138 S. Ct. 2080, 2091 (2018) (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)).[3] An analysis of the tax under the

3. In finding that the tax ran afoul of the Commerce Clause, the North Carolina Business Court held that the tax did not satisfy the first or fourth prong, and did not address the other two prongs.

Complete Auto Transit test shows that North Carolina's tax does not fulfill any of these requirements, much less all of them.

The substantial nexus requirement commands that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). For example, in the wake of *Wayfair*, Pennsylvania's intermediate appellate court rejected a Commerce Clause challenge to a Pennsylvania personal income tax upon non-resident taxpayers because the underlying entity derived its income from real property owned in Pennsylvania, which created a substantial nexus with the state. *Andrews v. Commonwealth of Pennsylvania*, 196 A.3d 1090, 1098 (Pa. Commw. Ct. 2018).

The operative activity – Respondent accumulating undistributed income – and the taxpayer (the trustee) did not create a nexus with North Carolina, much less a substantial nexus. The trustee did not live or work in North Carolina, none of the income was earned in North Carolina, and the trust did not own any assets in North Carolina. Nor was a cent distributed from the trust to anyone in North Carolina. The presence of discretionary beneficiaries in the State of North Carolina was incidental to the taxpayer's activities.

Kimberly Rice Kaestner Family Trust, 2015 WL 1880607, at *9. Specifically, the Business Court held that the discretionary beneficiaries' presence in North Carolina was "some contact" but hardly a "substantial nexus." Likewise, it found the taxpayer (the trustee) had no presence within the state.

Wayfair does not change this analysis. *Wayfair* dispensed with the physical presence requirement, dubbing it "artificial, anachronistic . . . unsound and incorrect." *Wayfair*, 138 S. Ct. at 2099. But this does not alter the outcome, as the state still must show that the tax is applied to an activity with a substantial nexus with the taxing state and that the taxpayer availed itself of the "substantial privilege" of conducting business in the jurisdiction. *Wayfair*, 138 S. Ct. at 2099. This is not the case here, as North Carolina's tax is designed to capture all income earned by a trustee, regardless of whether the trustee used or profited from any of North Carolina's services.[4]

Nor is the tax fairly apportioned. This prong of the *Complete Auto Transit* test serves to "ensure that each [s]tate taxes only its fair share of an interstate transaction." *Oklahoma Tax Com'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184 (1995). Doing so requires analyzing whether the tax is both internally consistent and externally consistent. Internal consistency is achieved "when the imposition of a tax identical to the one in question by every other [s]tate would add no burden to interstate commerce that intrastate commerce would not also bear." *Jefferson Lines, Inc.*, 514 U.S. at 185. This Court described utility of this test three years ago in *Comptroller of Maryland Treasury v. Wynne*:

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4. For this reason, tax practitioners and commentators have speculated that *Wayfair* would have a minimal impact on state taxation of trusts. Richard W. Nenno, *Minimizing or Eliminating State Income Taxes on Trusts*, Koren Estate, Tax, and Personal Financial Planning Update (August 2018 ed.).

> By hypothetically assuming that every State has the same tax structure, the internal consistency test allows courts to isolate the effect of a defendant [s]tate's tax scheme. This is a virtue of the test because it allows courts to distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other [s]tates, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes. The first category of taxes is typically unconstitutional; the second is not.

Comptroller of Maryland Treasury v. Wynne, 135 S. Ct. 1787, 1802 (2015) (internal citations omitted).

If imposed nationwide, the North Carolina tax would discriminate against interstate commerce, as it would create double taxation upon any trust where the trustee resided in a state that taxed trust income, and a trust beneficiary, intentionally or not, resided in a different state.[5] In some instances, this would be unavoidable. As an illustration, consider a testamentary trust where the trustee had absolute discretion over distributing trust income, and a minor beneficiary resided in another state, and since she was a minor, could not relocate. Under the North Carolina law, the trustee would be subjected to

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5. Subjecting interstate commerce "to the risk of a double tax burden to which intrastate commerce is not exposed" is forbidden by the Commerce Clause. *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938).

double taxation, and would be without recourse, as neither the trustee nor the beneficiary could relocate.[6]

This scheme would also create a sea change in trusts and estates practice for inter vivos trusts, as every time a beneficiary relocated to another state, grantors and trustees would be compelled to create a new trust (or decant a trust into a new trust) to avoid double taxation. Arguably, a trustee would be breaching its fiduciary duty if the trustee did not create a new trust (or decant).

The tax also fails to be externally consistent, which seeks "to discover whether a [s]tate's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing [s]tate." *Jefferson Lines, Inc.*, 514 U.S. at 185. As none of Respondent's activity occurred within North Carolina, the tax reaches beyond its permissible scope.[7] Additionally, as noted above, a blanket application of North Carolina's law exposes the taxpayer (the trustee) to multiple taxation if the trustee is also paying income tax to the state in which she resides.[8]

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6. This is why the tax also fails the third prong of *Wayfair* and *Complete Auto Transit*, as it is plainly discriminates against interstate commerce; here, there are a trustee and a trust beneficiary in different states.

7. Similarly, the tax fails the fourth prong of *Wayfair* and *Complete Auto Transit*, which requires that the tax bear some relation to the services provided by North Carolina. The services that North Carolina and its *amici* claim the state is providing (such as public education) are to the beneficiary, not the taxpayer.

8. "The threat of real multiple taxation . . . may indicate a state's impermissible overreaching." *Jefferson Lines*, 514 U.S. at 185; *see also J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938).

B. In the Alternative, the Matter Should be Remanded for Commerce Clause Consideration.

In the event the Court reverses on Due Process grounds and does not hold that North Carolina's tax is unconstitutional under the Dormant Commerce Clause, it should remand for further proceedings to develop a record concerning whether the tax violates the Commerce Clause. For example, a tax will not be externally consistent when the taxpayer demonstrates "by clear and cogent evidence that the income attributed to the [s]tate is in fact out of all appropriate proportions to the business transacted in that [s]tate."[9] *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983) (citing *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931)). The parties should be permitted to develop a record to ascertain whether this was the case.

Additional findings of fact would also be necessary to ascertain if North Carolina's tax poses an undue burden and violates the balancing test set forth *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). Indeed, this Court noted in *Wayfair* that *Pike* is one of several other aspects of Commerce Clause jurisprudence that can be used to ascertain a statute's constitutionality. *Wayfair*, 138 S. Ct. at 2098-99. The same is true as to whether North Carolina's tax impermissibly results in out-of-state taxpayers being subjected to double-taxation, whereas a domestic trust would not be. *See Wynne*, 135 S. Ct. at 1822.

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9. *Container Corp.* concerned an apportionment formula between two states. While this is not the case here, the overarching principle applies.

CONCLUSION

For the foregoing reasons, NYSBA respectfully submits that the decision below should be affirmed.

Respectfully submitted,

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No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

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INTRODUCTION

Quill's minimum-connection analysis centers on fundamental fairness. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992). As the Department's opening brief showed, this fairness-based analysis supports the tax at issue here.

Because a trust is just a relationship between multiple people, a trust has no jurisdictional contacts of its own. *Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016). Instead, its contacts are those of the people in the trust relationship. *See Greenough v. Tax Assessors*, 331 U.S. 486, 495 (1947).

Of the people in the trust relationship, the beneficiary—the trust's central figure—has the most important jurisdictional contacts. Pet'r's Br. 29–33. After all, serving the beneficiary's interests is a trust's reason for being. *Id.* at 29–30. When a state provides benefits and protections to a trust beneficiary, the state benefits her trust. *Id.* at 30–36.

In light of this reality, the tax here is fundamentally fair: North Carolina has given the Kaestner Trust something for which the state can ask for taxes in return. *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24–25 (2008) (applying this standard).

The Trust's response does not meaningfully rebut this analysis. Instead, the Trust repeatedly relies on two false premises to argue that trustees' contacts alone count for due-process purposes.

First, the Trust relies on the premise that a trustee is the true owner of trust income. That argument conflicts with core principles of trust law. Trust law makes beneficiaries, not trustees, the true owners of trust assets. Because of a beneficiary's ownership interest, her jurisdictional contacts count at least as much as a trustee's contacts do.

Second, the Trust relies on the premise that when North Carolina taxes trust income, the state is taxing the trustee, not the trust. This argument contradicts the arguments that the Trust made in its brief in opposition to certiorari.

In any event, the Trust's new argument is mistaken. The operative statute taxes trusts, not trustees. Further, taxes on trust income economically affect beneficiaries, not trustees.

Once these linchpins of the Trust's response are removed, little remains.

The Trust's doctrinal arguments misunderstand this Court's decisions on due process and trust taxation. The Trust relies on *Pennoyer*-era cases, as well as cases that did not involve taxes on a trust. The Trust is mistaken when it argues that "those precedents control here." Resp't's Br. 12.

Nor has the Trust explained away the massive tax shelter that its proposed rule would create. To the contrary, the Trust's brief heightens those concerns. The Trust proposes a rule that would invalidate statutes in a majority of the states.

Nothing in the Due Process Clause requires such a result. Under *Quill*'s fairness-based analysis, due process does not bar states from taxing a resident beneficiary's trust income.

ARGUMENT

I. The premises of the Trust's arguments are false.

A. A trustee is not the true owner of a beneficiary's trust income.

The Department's opening brief showed that, out of the people in the trust relationship, the beneficiary has the most important jurisdictional contacts. Pet'r's Br. 29–33. In response, the Trust tries to diminish the beneficiary's status. It claims that "there is no basis to treat [trust] income as if" it belongs to the beneficiary. Resp't's Br. 14; *see id.* at 40. The Trust goes on to argue that the trustee is the "owner of the trust property," so only his contacts should count. *Id.* at 27.

The Trust's argument contradicts modern due-process analysis, as well as fundamental principles of trust law.

In a due-process challenge to a tax, "this Court concerns itself with the practical operation of the tax, that is, substance rather than form." *Am. Oil Co. v. Neill*, 380 U.S. 451, 455 (1965) (citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 443–44 (1940)).

When a state taxes trust income, that tax does not burden a trustee economically. Instead, "only [the beneficiary] is ultimately burdened." *Stone v. White*, 301 U.S. 532, 538 (1937). In *Stone*, the Court recognized that "in the realm of reality it was the beneficiary's

money which paid the tax." *Id.* at 535. The Court declined to "shut its eyes to [that] fact." *Ibid.*[1]

The reality that *Stone* acknowledged is a bedrock principle of trust law: Beneficiaries—not trustees—are the true owners of their trust assets. John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 181 (1997); *see*, *e.g.*, *People v. Mishkin*, 521 N.Y.S.2d 296, 296 (App. Div. 1987) (referring to beneficiaries as "the true owner[s]" of trust assets); *Tyndall v. Tyndall*, 119 S.E. 354, 356 (N.C. 1923) (referring to a beneficiary as "the real owner" of trust assets).

The facts here underscore this principle of trust law:

- As Ms. Kaestner herself testified, the Trust here existed for one purpose: "to give me money." App. 82.
- During all of the tax years at issue, Ms. Kaestner and her children were the only people eligible to receive distributions. App. 46–47 (art. 1.2(a)–(b)).

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[1] The Trust tries to distinguish *Stone* by noting that the beneficiary in that case had a right to income for life. Resp't's Br. 40–41. But nothing in *Stone* suggests that the Court's rationale turned on any feature of the trust instrument in that case. Indeed, the Court implied the opposite: It noted that "*whenever* the trustee brings suit" on behalf of a trust, that lawsuit "is for the benefit and in the equitable interest of the [beneficiary]." *Stone*, 301 U.S. at 536 (emphasis added).

- The trust instrument required that Ms. Kaestner personally receive all of the trust assets in 2009, when she turned 40. App. 47 (art. 1.2(c)(1)); App. 83. The only reason why Ms. Kaestner did not receive those assets in 2009 was that the trustee decanted the trust assets into another trust—an event that occurred only after the trustee consulted with Ms. Kaestner. App. 97; Pet'r's Br. 9–10.

- A few years after the decanting, Ms. Kaestner did receive trust assets. N.C. R. 214–15.[2]

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[2] Despite these facts, the Trust refers repeatedly to Ms. Kaestner as a "contingent" beneficiary, without ever defining that label or stating any reason why the label might matter for due-process purposes. *E.g.*, Resp't's Br. i (Question Presented). For at least three reasons, the label does not help the Trust.

First, what matters for due process is not how an interest is labeled, but whether a resident beneficiary is eligible to receive distributions at the time of the tax. *See infra* pp. 19–21, 23–25. Here, during all of the tax years at issue, the only beneficiaries eligible to receive distributions were Ms. Kaestner and her children, who were North Carolinians during these years. App. 46–47 (art. 1.2(a)–(b)).

Second, the Trust's label contradicts the Trust's own complaint. The complaint describes Ms. Kaestner and her children as the Trust's "current beneficiaries." App. 11. It contrasts them with the Trust's "contingent remainder beneficiaries," who live outside of North Carolina. App. 11.

Third, Ms. Kaestner's interest was not "contingent" in any meaningful sense. She was required to receive all the trust assets in June 2009, just six months after the tax years at issue. App. 47 (art. 1.2(c)(1)).

Trust law describes this type of interest in trust assets as a beneficiary's equitable interest. *Commonwealth v. Stewart*, 12 A.2d 444, 447 (Pa. 1940), *aff'd mem*., 312 U.S. 649 (1941); *Blair v. Comm'r*, 300 U.S. 5, 14 (1937). Her equitable interest is "an *actual property interest* in the subject-matter of the trust." *Stewart*, 12 A.2d at 446–47 (emphasis added); *accord Blair*, 300 U.S. at 14; Trust Profs.' Br. 9–12.

The trustee's interest in trust assets, by contrast, is "merely nominal." Langbein, *supra*, at 181. The trustee has no interest in trust property "other than as the depositary of the legal title." *Robertson v. Bullions*, 11 N.Y. 243, 270 (1854); *Tyndall*, 119 S.E. at 356 (same).

Thus, in every meaningful sense, a beneficiary, not a trustee, is the true owner of the assets in a trust.

A hypothetical illustrates this point. Suppose that a trustee used some of the trust income to buy himself a car, then defended his action on the theory that he was the true owner of the trust assets. No court would accept that defense. *See*, *e.g.*, *Mishkin*, 521 N.Y.S.2d at 296 (rejecting trustee's "contention that he had a right of ownership equal to that of the . . . beneficiaries").

In sum, a key premise of the Trust's argument that only the trustee's contacts should count—the premise that the trustee is the real owner of trust property—is false.

B. North Carolina taxed the Trust, not the trustee.

The Trust's response also depends on a second false premise: that "[t]he State sought to tax the trustee," not the Trust. Resp't's Br. 33. Relying on that premise, the Trust argues that the Court should "focu[s] on whether the trustee *himself* has minimum contacts with North Carolina." *Id.* at 34.

That argument clashes with what the Trust argued in all of the North Carolina courts and in its brief in opposition to certiorari.

- For example, in the state supreme court, the Trust argued that "it is the entity the state seeks to tax—*here the Trust*—that must have the connection with the forum state." Resp't's N.C. S. Ct. Br. 27 (emphasis added).
- Likewise, at the petition stage in this Court, the Trust framed this case as one in which "the State sought to tax the . . . income of a trust." Resp't's Cert. Opp. i (Question Presented). It went on to argue that "[t]he Kaestner Trust has no connection to North Carolina." *Id.* at 8.

The Trust is now retreating from its insistence on trust-level contacts—and for good reason. As the Department has argued throughout this case, a trust is merely a fiduciary relationship between people, not "a distinct legal entity." *Americold*, 136 S. Ct. at

1016.[3] Therefore, a trust cannot make entity-level connections between "itself" and a state. Pet'r's Br. 16.

To try to save the state-court judgment on alternative grounds, the Trust now argues that "[t]he State sought to tax the trustee." Resp't's Br. 34. It goes on to argue that the real question here is "whether the trustee *himself* has minimum contacts with North Carolina." *Ibid*.[4]

That new argument fails for multiple reasons.

First, the argument was not preserved in—and, indeed, contradicts—the Trust's brief in opposition to certiorari. Under these circumstances, this Court "typically will not address a question . . . even if the answer would afford an alternative ground for affirmance." *MeadWestvaco*, 553 U.S. at 31; *see* S. Ct. R. 15.2.

Second, the Trust's new argument fails on the merits. North Carolina is not imposing an income tax on Mr. Bernstein personally; it is taxing "the taxable income of the . . . trust." N.C. Gen. Stat. § 105-160.2

3 The Court in *Americold* noted that "when a trustee files a lawsuit or is sued *in her own name*, her citizenship is all that matters for diversity purposes." 136 S. Ct. at 1016 (emphasis added). Here, however, only the Trust is the plaintiff. The trustee is not a party.

4 A number of amici apply this same mistaken premise. *See*, *e.g.*, Prof. Brilmayer Br. 11, 17–21; Chamber of Commerce Br. 3, 15–17.

(2017). That is why the Trust—and not Mr. Bernstein—is the plaintiff in this lawsuit.

In the decision under review, the state supreme court agreed that the statute taxes trusts, not trustees. Pet. App. 4a. The court described the trustee as the person who "physically" sends in the tax payment on behalf of the trust. Pet. App. 12a (citing N.C. Gen. Stat. § 105-160.2).

Despite all this, the Trust claims that "the trustee is liable for taxes assessed on the trust." Resp't's Br. 37. It cites a treatise for that proposition. *See* Myron Kove, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 265, at 130 (rev. 3d ed. 2012) [hereinafter Bogert]. That section of the treatise, however, says the opposite: "[T]he trustee is *not* personally liable for income taxes assessed on the trust's taxable income." *Ibid.* (emphasis added).

Citing the same section, the Trust also claims that "the trustee is liable . . . for failure to file returns or pay taxes." Resp't's Br. 37 (citing Bogert, *supra*, § 265). Again, however, that section says the opposite: Unpaid trust taxes are "collectible from the trust estate . . . but *not* from the personal estate of the trustee." Bogert, *supra*, § 265, at 128 (emphasis added).[5]

[5] The Trust also cites the Uniform Trust Code. Resp't's Br. 37 (citing Unif. Trust Code § 816 (Unif. Law Comm'n 2000)). But the cited code section states only that a trustee is authorized to remit taxes on the trust's behalf, not that the trustee pays those taxes with his own money. Unif. Trust Code § 816.

As these points show, North Carolina did not tax the trustee here. That false premise undermines the Trust's argument that a due-process analysis should be limited to the trustee's contacts alone.

* * *

In sum, the two major premises of the Trust's arguments are false. The failure of those premises shows why a trustee's contacts are not the only contacts that count for due-process purposes. Instead, as shown above and in the Department's opening brief, the beneficiary—the trust's central figure—has the most important jurisdictional contacts. Pet'r's Br. 29–33; *supra* pp. 4–7.

II. The Trust misunderstands this Court's decisions on due process and taxation.

A. The Trust's reliance on *Pennoyer*-era cases is mistaken.

The Trust begins its doctrinal arguments by emphasizing two of this Court's *Pennoyer*-era decisions: *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929), and *Brooke v. City of Norfolk*, 277 U.S. 27 (1928). For several reasons, those cases do not carry the day here.

First, those cases applied a physical-presence test that is inconsistent with modern due-process analysis.

Safe Deposit demanded that the trust assets at issue be "actual[ly] presen[t]" in the taxing state. 280 U.S. at 92. The majority opinion uses the word "situs" ten times. *Id.* at 91–94.

Brooke, too, relies on presence-based reasoning. The *Brooke* Court found it pivotal that "the property held in trust has remained in Maryland and no part of it is or ever has been in Virginia." 277 U.S. at 28.

These presence-focused cases have been "superseded by developments in the law of due process." *Quill*, 504 U.S. at 308. Twice within the last five years, the Court has cautioned that *Pennoyer*-era precedents "should not attract heavy reliance today." *Daimler AG v. Bauman*, 571 U.S. 117, 138 n.18 (2014); *accord BNSF Ry. Co. v. Tyrrell*, 137 S. Ct. 1549, 1557–58 (2017).

The Trust tries to shore up *Safe Deposit* and *Brooke* by arguing that they reflect a "practical realit[y]" that the trustee is the one true owner of a beneficiary's trust income. Resp't's Br. 18. That explanation, however, overlooks the actual reasoning in *Safe Deposit* and *Brooke*—reasoning that focuses on physical presence, not economic reality. *See supra* p. 12.

More importantly, the Trust's view of practical reality is the opposite of the actual reality that this Court recognized in *Stone*: the reality that trust money is "the beneficiary's money." 301 U.S. at 535; *see supra* pp. 4–7.

In sum, the Trust's argument contradicts first principles of trust law, as well as this Court's later decisions in *Stewart*, *Blair*, and, most notably, *Stone*.[6]

The Trust's reliance on *Safe Deposit* and *Brooke* is misplaced for a second reason as well: Even aside from their *Pennoyer*-era reasoning, these cases have been separately undercut by later decisions.

Safe Deposit relies heavily on the idea that the Due Process Clause bars taxation by more than one

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[6] The Trust also tries to refigure *Greenough* as a case that calls a trustee the one true owner of trust assets. Resp't's Br. 21–22. *Greenough* does not endorse the Trust's view. The *Greenough* Court explicitly based its holding on the benefits and protections that the taxing state provided to the trust. The Court expressly "restrict[ed its] discussion and determination" to rejecting the argument that Rhode Island offered no "protection of or benefit to the trust fund." *Greenough*, 331 U.S. at 490.

state. That doctrine was overruled in *Curry v. McCanless*, 307 U.S. 357, 363 (1939).

The Trust's only answer to *Curry* is to point out that the Court's analysis of double taxation started to shift even earlier. Resp't's Br. 19 n.3. But that point only highlights that *Safe Deposit* was infirm before *Curry* dealt the fatal blow.[7]

Brooke, another *Pennoyer*-era decision, suffered a similar fate. There, the Court held that the Due Process Clause bars a state from taxing beneficiaries on trust property that is not physically present in that state. 277 U.S. at 29. Thirteen years later, however, the Court reversed course.

In *Stewart*, the Court affirmed a state supreme court's decision that the Due Process Clause *allows* a state to tax beneficiaries on trust property that is not physically present there. 12 A.2d at 446–47, *aff'd mem.*, 312 U.S. 649. Over the dissent of Justice McReynolds, the author of the majority opinion in *Safe Deposit*, the Court held that Pennsylvania could tax a resident beneficiary on her equitable interest in a trust—the same property interest that makes Ms.

[7] Although the Trust admits that *Safe Deposit*'s double-taxation reasoning is no longer good law, the Trust still complains that the tax here could produce double taxation. Resp't's Br. 19 n.3. The Trust, however, does not claim that any actual double taxation happened here. During the tax years at issue, the Trust paid virtually no trust-income tax in any state except North Carolina. Pet'r's Br. 43–45.

Kaestner the true owner of her trust income here. *See supra* pp. 4–7.

The Trust does not address *Stewart* at all.

Finally, *Safe Deposit* and *Brooke* are distinguishable because they both involved property taxes. *Safe Deposit*, 280 U.S. at 90; *Brooke*, 277 U.S. at 28. This case, in contrast, involves income taxes.

For due-process purposes, the Court has long distinguished property taxes from income taxes. *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314 (1937); *accord Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 187–88 (1983); *Greenough*, 331 U.S. at 491–92.

Property taxes and income taxes are "predicated upon different governmental benefits." *Graves*, 300 U.S. at 314. Property taxes are constitutional because a state protects property itself. *Container Corp.*, 463 U.S. at 188. Income taxes, in contrast, are "founded upon the [state's] protection afforded to the recipient of the income." *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932).

Because of this difference, the Court has cautioned that the "single situs" reasoning that often applies to property taxation should "carry little force in the case of income taxation." *Container Corp.*, 463 U.S. at 188 (quoting *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 445 (1980)). Under this principle, the single-situs reasoning in *Safe Deposit* and *Brooke* carries little force here. Tax Profs.' Br. 16–18.

In sum, *Safe Deposit* and *Brooke* offer no guidance on the question presented.

B. The Court's decisions in *Hanson* and *Shaffer* do not control.

1. *Hanson* is inapposite here.

The Trust argues that *Hanson v. Denckla*, 357 U.S. 235 (1958), controls this case. Resp't's Br. 23–30. That argument fails for at least three reasons.

First, *Hanson* is distinguishable because it involved jurisdiction over a trustee, not a trust. 357 U.S. at 254–55. The issue in *Hanson* was whether a Delaware trustee could be haled into a Florida court in a will contest. *Ibid.*

Here, the Department is not seeking to hale the trustee, Mr. Bernstein, across state lines. Instead, North Carolina taxed a resident beneficiary's *trust* on income that was generated exclusively for her benefit. For this reason, *Hanson* is inapposite.

Second, *Hanson* is distinguishable because the state imposition there was felt only by a nonresident of the forum state: the Delaware trustee. *Ibid.*

Here, in contrast, the imposition is ultimately felt by an *in-state* resident. As shown above, "only [the beneficiary] is ultimately burdened" by trust taxes. *Stone*, 301 U.S. at 538; *see supra* pp. 4–7. In economic terms, the taxes here affected only Ms. Kaestner, a North Carolinian.

Third, *Hanson* is distinguishable because the imposition there involved the burdens of being sued. *See Phillips Petroleum, Inc. v. Shutts*, 472 U.S. 797, 808 (1985) (describing these burdens). This case, in contrast, involves a tax—a purely economic imposition.[8] This imposition is limited, moreover, to "the amount of the taxable income . . . that is for the benefit of a resident of [North Carolina]." N.C. Gen. Stat. § 105-160.2.

For these reasons, the Trust's reliance on *Hanson* is misplaced.

2. *Shaffer* does not help the Trust here.

The Trust also relies on *Shaffer v. Heitner*, 433 U.S. 186 (1977). Resp't's Br. 47–49. The Trust argues that *Shaffer* stands for the broad proposition that "the acceptance of fiduciary obligations to a forum resident" does not support jurisdiction. *Id*. at 48.

The Court in *Shaffer* specifically noted, however, that the case did not involve a fiduciary-duty theory of jurisdiction. The Court stressed that the relevant statute based jurisdiction "not on [the defendants'] status as corporate fiduciaries, but rather on the presence of their property in the State." 433 U.S. at 214. It was that quasi-in-rem theory, not a theory based

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[8] The Trust and its amici are right that this Court's decisions on adjudicative jurisdiction have helped shape tax jurisdiction. *Hanson*, however, illustrates a key difference between these two doctrines—the nature of the imposition involved.

on fiduciary relationships, that the *Shaffer* Court rejected.

Moreover, the Trust's broad reading of *Shaffer* cannot be squared with *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 473 (1985), which held that an extensive contractual relationship can justify jurisdiction over a person. Nor can it be squared with *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960), which based jurisdiction on a relationship with in-state independent contractors.

Here, a trust's relationship with its beneficiary is at least as close as the relationships in *Burger King* and *Scripto*.[9] Indeed, a trust exists to serve its beneficiary; it cannot exist without her. Pet'r's Br. 29–30.

For these reasons, the Trust's arguments based on *Shaffer* are mistaken.

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In sum, the Court's due-process decisions do not support the Trust's effort to narrow the scope of trust taxation.

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[9] The Trust's reliance on *Kulko v. Superior Court*, 436 U.S. 84 (1978), fares no better. There, the defendant father's only relevant contact with California was that he allowed his daughter to live there with her mother. *Id.* at 92–93. The Court rejected this strained theory of a contact because it would "discourag[e] parents from entering into reasonable visitation agreements." *Id.* at 93. That concern has no relevance here.

III. The Trust's remaining arguments fail.

A. The Trust's new arguments do not succeed.

1. Tax jurisdiction does not depend on whether trust income is distributed.

The Trust argues that the fact that Ms. Kaestner did not receive distributions during the years at issue is constitutionally pivotal. *E.g.*, Resp't's Br. 8, 17. The Trust bases this argument on *Brooke v. City of Norfolk*, 277 U.S. 27 (1928). Resp't's Br. 16–17, 20–23.

Here, again, the Trust does not mention this Court's affirmance in *Commonwealth v. Stewart*, 12 A.2d 444 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941).

Stewart held that due process allowed a state to tax a resident beneficiary on *undistributed* trust assets. *Id.* at 447. *Stewart* cited two reasons why distributions are not constitutionally pivotal.

First, even though a trustee formally holds undistributed trust assets, a beneficiary's equitable interest in those assets provides the connection that justifies tax jurisdiction. *Id.* at 450. Ms. Kaestner holds this same equitable interest here. *See supra* pp. 4–7.

Second, when a trust accumulates trust assets, a trust beneficiary's home state "affords her the personal security that enables her to enjoy those resources." *Stewart*, 12 A.2d at 451. The Court expanded this principle in *Greenough*, 331 U.S. at 495. There, the Court held that it does not matter whether a trust constituent actually uses the state's benefits and

protections; all that matters is that she has the *opportunity* to do so. *Ibid.*

Here, during all of the tax years at issue, Ms. Kaestner and her children lived in North Carolina, enjoying taxpayer-funded benefits and protections. Pet'r's Br. 30–36. Whether the Trust made distributions or not, the state's protection of the Kaestners benefited the Trust. *Id.* at 33–36.

For example, North Carolina's regulation of banking gave the Trust the opportunity to make secure distributions and loans to Ms. Kaestner. *Id.* at 36. The Trust used that opportunity: It made a loan to Ms. Kaestner just a month after the tax period here. Pet. App. 3a. A few years later, it distributed trust assets to her. N.C. R. 214–15.

Finally, the Trust's "no distributions" argument overlooks the context in which the Trust was accumulating income.

A trust accumulates income for one purpose: eventually distributing that income to the beneficiary. *See supra* pp. 4–7. Here, Ms. Kaestner eventually received assets from the Trust. N.C. R. 214–15. If she had wanted to receive the trust assets sooner, in June 2009, she would have received them then. Those assets were decanted into a new trust only after consultation with Ms. Kaestner. App. 97; Pet'r's Br. 9–10.

In addition, a trust's accumulation of income has immediate benefits for the beneficiary. As noted above, trusts can make low-interest-rate loans to

beneficiaries, allowing them to enjoy the trust's accumulated income without paying any personal income tax. Tax Profs.' Br. 20–21. That is exactly what happened here. Pet. App. 3a; App. 99–100, 113.

Because of these realities, the Trust is wrong to treat income distributions as constitutionally pivotal.

2. The Trust's "no purposeful availment" argument is mistaken.

The Trust argues that jurisdiction is lacking because Mr. Bernstein did not purposefully avail himself of the taxing state. Resp't's Br. 12–15, 34, 47–49.

That argument fails because North Carolina did not tax Mr. Bernstein; it taxed the Trust. *See supra* pp. 8–11. The economic effect of the tax was felt only by Ms. Kaestner, a North Carolinian. *See Stone*, 301 U.S. at 538; *supra* pp. 4–7.

Moreover, the Trust's argument assumes that the only purposeful availment that counts for the Trust is the trustee's purposeful availment. Instead, just as the contacts that count for due-process purposes are those of the trust constituents, a trust's purposeful availment takes place through a trust constituent—the grantor, the trustee, or the beneficiary. *See Greenough*, 331 U.S. at 495; Pet'r's Br. 25–28.

Under that principle, the Trust purposefully availed itself of North Carolina. The Trust's central constituent, Ms. Kaestner, was a North Carolina

resident throughout the tax years at issue. As a resident, Ms. Kaestner enjoyed extensive benefits and protections from the state. Pet'r's Br. 30–36. Those state benefits and protections benefited the Trust in multiple ways—most notably, by helping the Trust conserve its income. *Id.* at 33–36. The Trust leaves that argument unanswered.

Indeed, North Carolina protected Ms. Kaestner throughout the life of the Trust. When the Kaestner Trust was created, Ms. Kaestner had been living in North Carolina for years.[10] Pet. App. 2a–3a.

By that time, moreover, North Carolina's trust-tax statute had been on the books for more than 75 years. The statute explicitly taxes trust income "that is for the benefit of a resident of [North Carolina]." N.C. Gen. Stat. § 105-160.2. This statutory language gave the Trust and its constituents fair warning that the Trust would be taxed in North Carolina. *See Quill*, 504 U.S. at 312 ("We have . . . often identified 'notice' or 'fair

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[10] The Trust was split off from the Rice Family Trust in 2002 and formally established as a separate trust in 2006. Pet'r's Br. 7–8; Pet. App. 3a. Ms. Kaestner moved to North Carolina in 1997. Pet. App. 2a–3a.

Thus, Professor Brilmayer's arguments about the Trust apply a mistaken factual assumption: that Ms. Kaestner moved to North Carolina "well after the Trust was established." Prof. Brilmayer Br. 2; *see id.* at i, 3–4, 15 n.5, 17, 24–27.

The source of this mistaken assumption may be the Trust's inaccurate statement that Ms. Kaestner moved to North Carolina "five years after the trust's creation." Resp't's Br. 7. In actuality, the Kaestner Trust was created years after Ms. Kaestner moved to North Carolina.

warning' as the analytic touchstone of due process nexus analysis.").

Finally, even if one accepted the Trust's theory that Mr. Bernstein's purposeful availment is the only purposeful availment that matters, this case would still show purposeful availment. Resp't's Br. 34. When all of a trust's beneficiaries live in a given state, a trustee's fiduciary duty requires him to direct all of his efforts toward residents of that state. Tax Profs.' Br. 9.

For these reasons, the Trust's "no purposeful availment" argument fails.

3. The Trust's "absolute discretion" argument is contrary to trust law.

The Trust argues that the Trust lacked a minimum connection to North Carolina because the trustee had "absolute discretion" to treat Ms. Kaestner as he saw fit. Resp't's Br. 14, 45, 49. That argument exaggerates the trustee's discretion and its relevance here.

First, the Trust's "absolute discretion" argument misses the point. What matters for due-process purposes is whether a resident beneficiary is *eligible* to receive distributions at the time of the tax. *See supra* pp. 19–21. When a beneficiary is eligible for distributions, state services to the beneficiary benefit the trust. Pet'r's Br. 33–36. These state services help a trust conserve its income and garner investment returns. *Id.* at 31–32. Here, throughout the tax years

at issue, Ms. Kaestner and her children were the only people eligible for distributions from the Trust. *See* App. 46–47 (art. 1.2(a)–(b)).

In any event, the term "absolute discretion" in a trust instrument is not taken literally. Trust Profs.' Br. 13 n.5 (summarizing authorities). Instead, a trustee's fiduciary duty to trust beneficiaries limits his discretion. *Ibid*.

Even when a trust instrument gives trustees "sole and absolute discretion" to make distributions, it is "unacceptable for trustees to simply sit back and do nothing until a request is made." *In re Andrew C.*, 2017 WL 6821717, at *1 (N.Y. Sur. Ct. 2017).[11] Instead, trust law gives trustees "an affirmative duty to inquire with diligence into the quality of [a beneficiary's] life and to apply trust income towards significantly improving it."[12] *Ibid.*

Thus, if North Carolina had not protected Ms. Kaestner during the years at issue, Mr. Bernstein's fiduciary duties would have called for him to make distributions to meet her needs. If he refused those distributions on the ground that his "absolute discretion" did not require them, Ms. Kaestner would

[11] Here, the trust instrument states that New York law governs its interpretation. App. 69 (art. 10).

[12] The trust instrument here reinforced these duties. It "direct[ed]" the trustee to consider the trust "a family asset, and to be liberal in the exercise of the discretion conferred upon [him] and to use income and principal . . . to meet the needs of the beneficiaries." App. 51 (art. 1.4(c)).

have had a claim for breach of fiduciary duty. *See*, *e.g.*, *ibid.*

As these points show, the Trust's assertion that Mr. Bernstein "had no legal obligation to provide anything to [Ms. Kaestner] during the relevant period," Resp't's Br. 45, is irrelevant to a due-process analysis and contrary to trust law.

B. The Trust has not justified its proposed tax shelter.

The Trust's arguments here, if successful, would open up a massive tax shelter—an outcome that this Court recently rejected. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2094 (2018).

Under the Trust's proposed rule, to avoid state income taxes nationwide, all one would need to do is select a trustee in a state with no trust-income tax.[13]

The Trust responds with two alleged justifications for this tax shelter. Both fail.

First, the Trust argues that the Department is questioning other states' taxing choices. Not so. It is simply asking the Court to honor North Carolina's *own* taxing choices. The Department is also showing why

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[13] To try to make this tax shelter seem smaller, the Trust suggests that states might enact a "throwback" rule. Resp't's Br. 51–52. A throwback rule, however, would still allow beneficiaries like Ms. Kaestner to avoid state taxes on all of their trust income. All the beneficiaries would need to do is move to a strategically chosen state before taking a distribution. Pet'r's Br. 40.

North Carolina's tax is fundamentally fair—the central focus of the "minimum connection" test. *See Quill*, 504 U.S. at 306.[14]

The Department is also pointing out the practical consequences of the Trust's proposed rule: "significant revenue losses to the States." *Wayfair*, 138 S. Ct. at 2092. Avoiding those consequences would protect the same interest that the Trust claims to support: "the sovereign right of each state to set its tax policy." Resp't's Br. 15.[15]

The Trust also argues that a decision in its favor would not significantly disrupt states' taxing choices. The Trust is grossly mistaken. Its arguments, if accepted, would invalidate trust-tax statutes in a majority of the states.

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[14] One of the no-trust-tax states, South Dakota, explicitly argues that the trust-tax statutes in the majority of its sister states should fall so that South Dakota can maintain its "comparative economic advantage" and attract "the trust industry." S.D. Br. 1, 3; *see id.* at 7–8. Crediting arguments like those would create a race to the bottom in trust taxation—an effect that would insulate wide swaths of trust income from state taxes. Pet'r's Br. 39–43; Tax Profs.' Br. 18–25.

[15] The Trust and its amici suggest that the Department's arguments would allow corporations to be haled into court in states where their shareholders live. Resp't's Br. 56–57; Chamber Br. 1. Those concerns are unfounded.

The Department's argument applies only to trusts—unique arrangements that lack any entity status. Pet'r's Br. 22–25. The argument does not extend to legal entities, like corporations, that are capable of making entity-level contacts. *See Americold*, 136 S. Ct. at 1016.

The Trust is asking this Court to constitutionalize the following rule: Only the state where a trustee lives and the state where a trust is administered have the right to tax undistributed non-source income in a non-grantor trust. *Id.* at 50–51. That rule would not treat a beneficiary's residency or a grantor's residency as a proper jurisdictional connection. *See ibid.*

A majority of states tax trust income on the basis of beneficiary residency, grantor residency, or a set of factors that includes at least one of those connections. Tax Profs.' Br. 18–20; Twenty-one States' Br. 9–12. Thus, if the Court accepted the Trust's proposed rule, that ruling would strike down trust-tax statutes in a majority of states.[16]

In sum, the rule that the Trust seeks here would construct a tax shelter of multi-billion-dollar proportions. Pet'r's Br. 39–43 (describing these concerns further); Tax Profs.' Br. 18–25 (amplifying these concerns).

This Court has not hesitated to reject such a result. *See Wayfair*, 138 S. Ct. at 2100. This case calls for the same outcome.

[16] Tax Profs.' Br. 19. Indeed, thirty-three states use beneficiaries' residency or grantors' residency as a criterion for taxing trusts. *See* Richard W. Nenno, *Bases of State Income Taxation of Nongrantor Trusts* (Feb. 28, 2019), https://perma.cc/88UZ-Q7ML.

CONCLUSION

The state supreme court's decision should be reversed.

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