U.S. Supreme Court Limits the Ability of States to Tax a Trust – The Kaestner Case

B. Wade Bowen
wbowen@mwlaw.com
(870) 938.6254

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On June 21, 2019, the U.S. Supreme Court issued an opinion limiting the ability of a state to impose income taxes on a trust when the trust's connection with the taxing state is minimal. The case is styled *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust.*

In the *Kaestner* case, Joe Rice, III formed a trust for the benefit of his children, one of whom is Kimberly Kaestner. At the time of the trust's formation, Joe lived in New York, and his trust provided that its administration would be governed by New York law. The trust agreement initially appointed a New York resident as trustee. The New York trustee was succeeded by a new trustee who was a Connecticut resident during the time period relevant to the case. The trust agreement gave the trustee "absolute discretion" to distribute the trust's assets to the beneficiaries "in such amounts and proportions" as the trustee might "from time to time decide."

In 1997, Kimberly and her children moved to North Carolina, and their North Carolina residency was the trust's only connection to the state. North Carolina has a statute that taxes any trust income that "is for the benefit of" a North Carolina resident. Pursuant to that statute, the North Carolina Department of Revenue assessed a tax on the income accumulated for the benefit of Kimberly for tax years 2005 through 2008 and required the trustee to pay it. Notably, during the years in question, no distributions were made to Kimberly. The trustee was out of state, and no trust administration occurred within the state of North Carolina. The trustee made no direct investments in North Carolina.

The Court held that North Carolina's imposition of tax liability violated the Due Process Clause of the Fourteenth Amendment. In the trust beneficiary context, the ability of the taxing state depends upon the extent of the in-state beneficiary's right to control, possess, enjoy, or receive trust assets. In this instance, because Kimberly received no distributions and had no ability to compel distributions, North Carolina lacked the minimum connection necessary to tax the trust's income.

Interestingly, the Court limited its holding to the specific facts presented in the case, leaving open the possibility of upholding a state's ability to tax if even a slightly greater connection with the taxing state exists. Because, in the words of the Court, "we do not imply approval or disapproval of trust taxes that are premised on the residence of beneficiaries whose relationship to trust assets differs from that of the beneficiaries here," it seems that the door is open to future litigation with even slightly different facts.