No. _______

In the

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF NORTH CAROLINA

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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[ENTERED JUNE 8, 2018]

IN THE SUPREME COURT OF
NORTH CAROLINA

No. 307PA15-2

Filed 8 June 2018

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, 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

[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.

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

[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

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. 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

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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.

> 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.

[ENTERED JULY 5, 2016]

IN THE COURT OF APPEALS OF
NORTH CAROLINA

No. COA15-896

Filed: 5 July 2016

Wake County, No. 12 CVS 8740

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST, Plaintiff,

v.

NORTH CAROLINA DEPARTMENT
OF REVENUE, Defendant.

Appeal by defendant from order entered 23 April 2015 by Judge Gregory P. McGuire in Wake County Superior Court. Heard in the Court of Appeals 23 February 2016.

Attorney General Roy Cooper, by Assistant Attorney General Peggy S. Vincent, for the State.

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

BRYANT, Judge.

Where North Carolina did not demonstrate the minimum contacts necessary to satisfy the principles of due process required to tax an out-of-state trust, we affirm the lower court's grant of summary judgment in favor of the trust and uphold the order directing the Department of Revenue to refund taxes and penalties paid by the trust.

On 21 June 2012, representatives of plaintiff The Kimberley Rice Kaestner 1992 Family Trust (the Trust) filed a complaint against the North Carolina Department of Revenue (the Department) after the Department denied a request to refund taxes the Trust paid during tax years 2005 through 2008. The claims brought forth alleged that taxes imposed upon the Trust pursuant to N.C. Gen. Stat. § 105-160.2 were imposed in violation of due process, the Commerce Clause, and the North Carolina Constitution. Pursuant to section 105-160.2, taxes are "computed on the amount of taxable income of the estate or trust that is for the benefit of a resident of this State[.]"

In 1992, an *inter vivos* trust (original trust) was established by settlor Joseph Lee Rice III, with William B. Matteson as trustee. The situs, or location, of the original trust was New York. The primary beneficiaries of the original trust were the settlor's descendants (none of whom lived in North Carolina at the time of the trust's creation). In 2002, the original trust was divided into three separate trusts: one for each of the settlor's children (Kimberley Rice Kaestner, Daniel Rice, and Lee Rice). At that time in 2002, Kimberley Rice Kaestner, the beneficiary of plaintiff Kimberley Rice Kaestner 1992 Family Trust, was a resident and domiciliary of North Carolina. On 21 December 2005, William B. Matteson resigned as trustee for the three separate trusts. The settlor then appointed a successor trustee, who resided in Connecticut. Tax returns were filed in North Carolina on behalf of the Kimberley Rice Kaestner 1992 Family Trust for tax years ending in 2005, 2006, 2007, and 2008 for income accumulated by the Trust but not distributed to a North Carolina beneficiary. In 2009, representatives of the Trust filed a claim for a refund of taxes paid to the Department amounting to $1,303,172.00, for tax years 2005, 2006, 2007, and 2008. The claim was denied. Trust representatives commenced a contested case action in the Office of Administrative Hearings (OAH). However, the OAH dismissed the contested case for lack of jurisdiction: the sole issue was the constitutionality of the enabling statute, G.S. § 105-160.2. The current action commenced in Wake County Superior Court and, thereafter, was designated as a mandatory complex business case.

On 11 February 2013, the Honorable John R. Jolly, Jr., Chief Special Superior Court Judge for Complex Business Cases, entered an order ruling on a motion to dismiss filed by the Department.[1] Based on the Court's order, the Department asserted Rules 12(b)(1), (2), and (6) as a basis for dismissal of the constitutional claims and the injunctive relief. Judge Jolly found that "[N.C. Gen. Stat. §] 105-241.19 set out exclusive remedies for disputing the denial of a requested refund and expressly prohibit[ed] actions for injunctive relief to prevent the collection of a tax." Judge Jolly granted the Department's motion to dismiss the Trust's claim for injunctive relief which sought a refund of all taxes paid. However, Judge Jolly denied the Department's motion to dismiss the Trust's constitutional claims, concluding "there is at least a colorable argument that North Carolina's

[1] The Department's motion to dismiss was not made a part of the record on appeal.

imposition of a tax on a foreign trust based solely on the presence of a beneficiary in the state does not conform with the Due Process Clause, the Commerce Clause or Section 19 [of Article I of the North Carolina Constitution]."

On 8 July 2014, the Trust moved for summary judgment, alleging there were no genuine issues of material fact: the Trust had paid the State of North Carolina over $1.3 million in taxes for tax years 2005 through 2008; the Trust was established by a non-resident settlor, governed by laws outside of North Carolina, operated by a non-resident trustee, and did not make any distributions to a beneficiary residing in North Carolina during the pertinent period. The Trust requested that the court declare General Statutes, section 105-160.2 unconstitutional and order a refund of all taxes and penalties paid by the Trust.

The Department also filed a motion for summary judgment. In it, the Department acknowledged that all of the Trust assets were intangibles, and that during the pertinent years, the Trust beneficiaries received no distributions from the Trust. However, quoting a case from the State of Connecticut, *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 204–05, 733 A.2d 782, 802 (1999), the Department stated:

> [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.*

(emphasis added).

A summary judgment hearing was held in Wake County Superior Court before the Honorable Gregory P. McGuire, Special Superior Court Judge for Complex Business Cases. In an order entered 23 April 2015, Judge McGuire granted the motion for summary judgment filed on behalf of the Trust and denied the Department's motion. Judge McGuire concluded that N.C. Gen. Stat. § 105-160.2 was unconstitutional as applied and ordered the Department to refund any taxes and penalties paid pursuant to that statute. The Department appeals.

On appeal, the Department argues that the Trust cannot meet its burden to prove it is entitled to a refund of state taxes paid on its accumulated income. Specifically, the Department contends that the Business Court erred when it concluded that taxation of the Trust based on the residence of the beneficiary violated

(A) due process under both the federal and state constitutions, as well as (B) the Commerce Clause of the federal constitution. We disagree.

Standard of Review

> When assessing a challenge to the constitutionality of legislation, this Court's duty is to determine whether the General Assembly has complied with the constitution. . . . In performing our task, we begin with a presumption that the laws duly

> enacted by the General Assembly are valid. *Baker v. Martin*, 330 N.C. 331, 334, 410 S.E.2d 887, 889 (1991). North Carolina courts have the authority and responsibility to declare a law unconstitutional, but only when the violation is plain and clear. *State ex rel. Martin v. Preston*, 325 N.C. 438, 449, 385 S.E.2d 473, 478 (1989). Stated differently, a law will be declared invalid only if its unconstitutionality is demonstrated beyond reasonable doubt. *Baker*, 330 N.C. at 334–35, 410 S.E.2d at 889.

Hart v. State, 368 N.C. 122, 126, 774 S.E.2d 281, 284 (2015).

Due Process

The Department contends that the trial court erred when it concluded that taxation of the Trust based solely on the residence of the beneficiaries violated due process under both the federal and state constitutions.

"The Fourteenth Amendment to the United States Constitution provides that '[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law[.]' U.S. Const. amend. XIV." *Johnston v. State*, 224 N.C. App. 282, 304, 735 S.E.2d 859, 875 (2012) (alteration in original), *writ allowed*, *review on additional issues denied*, 366 N.C. 562, 738 S.E.2d 360, *aff'd*, 367 N.C. 164, 749 S.E.2d 278 (2013). "No 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. " 'The 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)). "For purposes of taxation, 'the requirements of . . . "due process" are, for all practical purposes, the same under both the State and Federal Constitutions.' " *In re appeal of Blue Ridge Hous. of Bakersville LLC*, 226 N.C. App. 42, 58, 738 S.E.2d 802, 813 (2013) (citation omitted) (quoting *Leonard v. Maxwell*, 216 N.C. 89, 93, 3 S.E.2d 316, 320 (1939)).

> In analyzing federal constitutional questions, we look to decisions of the United States Supreme Court. We also look for guidance to the decisions of the North Carolina Supreme Court construing federal constitutional and State constitutional provisions, and we are bound by those interpretations. *State v. Elliott*, 360 N.C. 400, 421, 628 S.E.2d 735, 749, (2006) ("The Supreme Court of the United States is the final authority on federal constitutional questions.")[.] We are also bound by prior decisions of this Court construing those provisions, which are not inconsistent with the holdings of the United States Supreme Court and the North Carolina Supreme Court. *In the Matter of Appeal from Civil Penalty*, 324 N.C. 373, 379 S.E.2d 30 (1989).

Johnston, 224 N.C. App. at 288, 735 S.E.2d at 865.

> The Commerce Clause and the Due Process Clause impose distinct but parallel limitations on a State's power to tax out-of-state activities. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 305–306, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992). . . . The "broad inquiry" subsumed in both constitutional requirements is whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state—that is, whether the state has given anything for which it can ask return.

MeadWestvaco Corp. ex rel. Mead Corp. v. Ill. Dep't of Revenue, 553 U.S. 16, 24–25, 170 L. Ed. 2d 404, 412 (2008) (citations and quotations omitted). "The 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." *Quill Corp. v. N. Dakota*, 504 U.S. 298, 306, 119 L. Ed. 2d 91, 102 (1992).

Minimum Contacts

As to the question of whether there exists some minimum connection between a state and the . . . property . . . it seeks to tax, *see id.*, "[our Supreme Court has] framed the relevant inquiry as whether a [party] had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.' " *Id.* at 307, 119 L. Ed. 2d at

103 (quoting *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316, 90 L. Ed. 95, 102 (1945)).

> Application of the "minimum contacts" rule 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) (citation and some quotation marks omitted).

On this point, we note that Judge McGuire made the following unchallenged findings of fact:

> 23. [N]othing in the record indicates, and [the Department] does not argue, that [the Trust] maintained any physical presence in North Carolina during the tax years at issue. The undisputed evidence in this matter shows that [the Trust] never held real property located in North Carolina, and never invested directly in any North Carolina based investments. . . . The record also indicates that no trust records were kept or created in North Carolina, or that the trust could be, in any other manner, said to have a physical presence in the State. Moreover, because the trustee's usual place of business where trust records were kept was outside the State, it is clear from the record that [the Trust's] principal place of administration was not North Carolina.

. . .

> 26. [The Department] concedes that the only "connection between the [Plaintiff] trust and North Carolina in the case at hand is the residence of the beneficiaries."

The Department supports its argument that the residence of the beneficiaries is sufficient to satisfy the minimum contacts criteria of the Due Process Clause by citing to state court opinions from Connecticut and California: *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 782 (1999), and *McCulloch v. Franchise Tax Bd.*, 61 Cal. 2d 186, 390 P.2d 412 (1964).

In both *Gavin* and *McCulloch*, the state appellate court noted that the United States Supreme Court had previously upheld the taxation of trust income based on the domicile of the *trustee*, citing *Greenough v. Tax Assessors*, 331 U.S. 486, 91 L. Ed. 1621 (1947). And the *Gavin* and *McCulloch* courts reasoned that similar to the benefits and protections provided by a state to a trustee, the state of the beneficiary's domicile provided benefits and protections sufficient to satisfy the minimum contacts criteria of due process for taxation of the trust. *See Gavin*, 249 Conn. at 204–05, 733 A.2d at 802 ("[J]ust as a state may tax all of the present income of a domiciliary, . . . a state may . . . tax the income of an inter vivos trust that is accumulated for the ultimate benefit of a noncontingent domiciliary, and that is subject to her ultimate power of disposition."); *McCulloch*, 61 Cal. 2d at 196, 390 P.2d at 419 ("[T]he 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."). On this basis, the Department contends that its taxation of the Trust, predicated solely on the residency of Kimberley Kaestner in North Carolina did not violate due process.

Representatives of the Trust, on the other hand, assert that the Department's contention that a beneficiary's domicile alone is sufficient to satisfy the minimum contacts requirement of the Due Process Clause and allow the state to tax a non-resident trust conflates what the law recognizes as separate legal entities—the trust and the beneficiary. "[W]e do not forget that the trust is an abstraction, . . . [and] 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 v. Wilson*, 289 U.S. 20, 27, 77 L. Ed. 1004, 1010 (1933). In other words, for income tax purposes the trust has a separate existence. *Id.*

In support of their position, the Trust representatives direct our attention to *Greenough*, 331 U.S. 486, 91 L. Ed. 1621, a United States Supreme Court opinion. *Greenough* upheld a Rhode Island law authorizing the levy of an *ad valorem* tax upon a resident *trustee* based on a proportionate legal interest of a foreign trust, finding no violation of due process. *Greenough* was a decision from which four justices, including the Chief Justice, dissented. We note with particular interest the dissent of Justice Rutledge, who wrote that "if the beneficiary's residence alone is insufficient to sustain a state's power to tax the corpus of the trust, *cf. Brooke v. Norfolk*, 277 [U.S.] 27, 72 [L. Ed.] 767, 48 [S. Ct.] 422, it would seem that the mere residence of one of a number of trustees hardly would supply a firmer foundation." *Id.* at 503, 91 L. Ed. at 1633 (footnote omitted). After a careful look at *Brooke*, 277 U.S. 27, 72 L. Ed. 767 (1928), we find it to be not only relevant to the instant case, but also controlling.

In *Brooke*, the petitioner—a Virginia resident and trust beneficiary—appealed to the United States Supreme Court after the City of Norfolk and the State of Virginia assessed taxes upon the corpus of a trust created by a Maryland resident. *Id.* at 28, 72 L. Ed. at 767–78. The petitioner contended that the assessment of the taxes was contrary to the Fourteenth Amendment. *Id.* at 28, 72 L. Ed. at 767. The Maryland resident created a testamentary trust and bequeathed to it $80,000.00, naming petitioner as beneficiary. The trustee, Safe Deposit & Trust Company of Baltimore, was directed to pay income from the trust to the petitioner for life. *Id.* at 28, 72 L. Ed. at 768. The Court noted that "[t]he property held in trust has remained in Maryland and no part of it is or ever has been in Virginia." *Id.*

> The petitioner has paid without question a tax upon the income received by her. But the doctrine contended for now is that the petitioner is chargeable as if she owned the whole. . . . But here 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. *See Wachovia Bank & T. Co. v. Doughton*, 272 U. S. 567, 575, 71 L. [E]d. 413, 419, 47 Sup. Ct. Rep. 202.

Id. 28–29, 72 L. Ed. at 768.

The strong similarities between the facts in *Brooke* and the instant case cannot be ignored. While the trust in *Brooke* was a testamentary trust and the Trust here an *inter vivos* trust, both were created and governed by laws outside of the state assessing a tax upon the trust. The trustee for both trusts resided outside of the state seeking to tax the trust. The beneficiary of the trust who resided within the taxing state had no control over the trust during the period for which the tax was assessed. And, the trusts did not own property in the taxing state.[2] In the instant case, the Trust's beneficiary did not receive a taxable distribution from the Trust during the years for which the Department has assessed a tax.

In determining that the authority as set forth by the United States Supreme Court in *Brooke* controls the analysis and outcome of this issue, we must decline the Department's request that we accept as persuasive the authority as set out by the California Supreme Court, *McCulloch*, 61 Cal. 2d 186, 390 P.2d 412, or the Connecticut Supreme

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[2] In *Brooke*, it was duly noted that the petitioner paid tax assessments in Virginia on the distributions made to her as a resident of the state; however, she had no duty under the law (or constitution) to pay taxes on the *corpus* of the trust which existed in another state and over which she had no control. *See* 277 U.S. at 28–29, 72 L. Ed. at 768.

Court, *Gavin*, 249 Conn. 172, 733 A.2d 782. Thus, because of *Brooke*, we hold that based on the facts of the instant case, the connection between North Carolina and the Trust was insufficient to satisfy the requirements of due process. Therefore, the Department's assessment of an income tax levied pursuant to the authority set out in General Statutes, section 105-160.2 was in violation of the Due Process Clause of the United States Constitution, and the Law of the Land Clause of the North Carolina Constitution. Accordingly, we affirm Judge McGuire's order granting summary judgment for the Trust and directing that the Department refund any and all taxes and penalties paid by the Trust pursuant to section 105-160.2 with interest.

As a consequence, we do not address the Department's contention that the Business Court erred when it concluded taxation of the Trust based on the residence of the beneficiary violated the Commerce Clause of the federal constitution.

AFFIRMED.

Judges STEPHENS and McCULLOUGH concur.

[ENTERED APRIL 23, 2015]

STATE OF NORTH CAROLINA

COUNTY OF WAKE

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COUNTY OF WAKE COURT DIVISION
12 CVS 8740

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST, Plaintiff	)	
v.	)	OPINION AND ORDER ON MOTIONS FOR SUMMARY JUDGMENT
NORTH CAROLINA DEPARTMENT OF REVENUE, Defendant	)	

THIS CAUSE, designated a mandatory complex business case by Order of the Chief Justice of the North Carolina Supreme Court, pursuant to N.C. Gen. Stat. § 7A-45.4(b), and assigned to the undersigned Special Superior Court Judge for Complex Business Cases, comes before the Court, pursuant to Rule 56 of the North Carolina Rules of Civil Procedure ("Rule(s)"), upon Plaintiff The Kimberley Rice Kaestner 1992 Family Trust's ("Plaintiff" or "Trust") Motion for Summary Judgment ("Plaintiff's Motion") and Defendant North Carolina Department of Revenue's ("Defendant") Motion for Summary Judgment ("Defendant's Motion") (together with Plaintiff's Motion, "Motions"). On February 24, 2015, the Court held a hearing on the Motions.

THE COURT, after reviewing the Motions, briefs in support of and in opposition to the Motions, arguments of counsel, and the evidence and other appropriate matters of record, CONCLUDES that Plaintiff's Motion should be GRANTED and Defendant's Motion should be DENIED for the reasons stated herein.

Moore & Van Allen PLLC by Thomas D. Myrick, Esq., Neil T. Bloomfield, Esq., and Kara N. Bitar, Esq. for Plaintiff The Kimberley Rice Kaestner 1992 Family Trust.

North Carolina Department of Justice by Peggy S. Vincent, Esq. for Defendant North Carolina Department of Revenue.

McGuire, Judge.

Procedural History

1. Plaintiff filed this action on June 30, 2012, seeking a determination that, as it was applied to Plaintiff, North Carolina General Statute § 105-160.2 (hereinafter, references to North Carolina General Statutes will be to "G.S.") violates the Due Process Clause and the Commerce Clause of the United States Constitution and Section 19 of the North Carolina Constitution. Plaintiff seeks a refund of all taxes, penalties, and interest paid by it pursuant to G.S. § 105.160.2 for the tax years 2005 through 2008. In its Complaint, Plaintiff also sought to enjoin Defendant from enforcing any assessments issued pursuant to G.S. § 105-160.2 and from issuing future assessments against Plaintiff based on the same provision.

2. On February 11, 2013, the Court granted, in part, Defendant's Motion to Dismiss pursuant to Rule 12(b)(6). In its Order on Motion to Dismiss, the Court dismissed Plaintiff's claim for injunctive relief, but denied the Motion to Dismiss as to the constitutional challenges to the statute.

3. On July 2, 2014, Plaintiff filed its Motion for Summary Judgment. On September 2, 2014, Defendant filed its Motion for Summary Judgment. Both Motions have been fully briefed and, on February 24, 2015, the Court held a hearing on both Motions.

4. Both Motions seek summary judgment in the parties' respective favors on the constitutionality of G.S. § 105-160.2. Therefore, for the purpose of this Opinion and Order, the Court will address the Motions together.

Factual Background

5. A court does not make findings of fact in ruling upon a motion for summary judgment. However, the court may summarize material facts that do not appear to be at issue and which justify the judgment. *Hyde Ins. Agency, Inc. v. Dixie Leasing Corp.*, 26 N.C. App. 138, 142 (1975). There is very little dispute as to any of the facts in this action, and the dispositive facts are undisputed.

6. In 1992, the Joseph Lee Rice, III Family 1992 Trust ("Family Trust") was created for the benefit of the children of Joseph Lee Rice, III ("Settlor") under a trust agreement between Settlor and the initial trustee, William B. Matteson.[1] In 2005, Matteson resigned as trustee

[1] Bernstein Aff. (July 2, 2014) ¶ 3.

of the Family Trust, and David Bernstein ("Bernstein"), a Connecticut resident and domiciliary, was appointed trustee.[2] Bernstein was the trustee of the Family Trust at all times relevant to this action.

7. The Family Trust was created in New York and is governed by New York Law.[3] At the time the Family Trust was created, Settlor and the initial trustee were residents and domiciliaries of New York.[4] At the time of its creation, no primary or contingent beneficiary was a resident or domiciliary of North Carolina.[5] In 1997, Kimberley Rice Kaestner ("Kaestner"), a daughter of the Settlor and a primary beneficiary of the Family Trust, relocated to North Carolina.[6]

8. On December 30, 2002, by operation of the trust agreement, the Family Trust was divided into separate share trusts for each of the Settlor's three children, including Kaestner.[7] In 2006, Bernstein "physically divided" the share trusts into three trusts.[8] Plaintiff is the separate share trust formed for the benefit of Kaestner.[9] The current beneficiaries of Plaintiff are Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina in the tax years at issue.[10] The contingent remainder beneficiaries

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[2] *Id.* ¶ 13.
[3] *Id.* ¶ 4.
[4] *Id.* ¶ 5.
[5] *Id.*
[6] *Id.* ¶¶ 7-8.
[7] *Id.* ¶ 7.
[8] Bernstein Dep. 6.
[9] Bernstein Aff. ¶ 7.
[10] *Id.* ¶ 10.

of Plaintiff are the Settlor's remaining children, the Settlor's spouse, and the Settlor's sister, none of whom are, or were, residents or domiciliaries of North Carolina.[11]

9. The Family Trust, which includes Plaintiff, is an irrevocable *inter vivos* trust.[12] The terms of the Family Trust provided that when Kaestner turned 40 years of age, the Trustee was to distribute the trust assets to Kaestner. Kaestner turned 40 on June 2, 2009. Prior to turning 40, Ms. Kaestner had conversations with her father and Bernstein as to whether she wished to receive the trust assets at her 40th birthday.[13] Kaestner determined she preferred to extend the Trust.[14] Accordingly, in 2009, prior to Kaestner's 40th birthday, Bernstein transferred the assets of the Trust into a new trust, the KER Family Trust. It is undisputed that the transfer of assets occurred after the tax years at issue in this case, and the KER Family Trust is not a party to this action.

10. During the tax years at issue in this case, the assets held by Plaintiff consisted of various financial investments including equities, mutual funds, and investments in partnerships. The custodian of Plaintiff's assets was located in Boston, Massachusetts. Other documents related to the Trust, including ownership documents of some assets of Plaintiff, financial books and records, and legal records, were all kept in New York.[15]

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[11] *Id.* ¶ 11.
[12] *Id.* ¶ 12.
[13] Kaestner Dep. 8-10.
[14] Kaestner Dep. 9.
[15] Bernstein Aff. ¶ 14.

Additionally, all tax returns and Trust accountings have been prepared in New York.[16]

11. Under the terms of the Trust, the beneficiaries, including Kaestner, had no absolute right to any of the assets or income of the Plaintiff, as the distributions of assets or income are made at the sole discretion of the trustee, Bernstein.[17] Furthermore, under the terms of the Trust, Bernstein had broad authority to manage the property held by the Trust "as if the absolute owner thereof."[18] During the years in question no distributions were made to a beneficiary in North Carolina.[19]

12. Notwithstanding the discretionary nature of the Trust and the broad authority granted to the trustee, it is undisputed that two loans were made from the Trust for the benefit of Kaestner or other beneficiaries. In 2007 or 2008, Plaintiff loaned $250,000.00 directly to Kaestner in order to allow her to pursue an investment in vanilla.[20] In 2008 or 2009, a loan was made from Plaintiff to a related trust, the Special Asset Trust, to enable the Special Asset Trust to make a capital call on a limited partnership interest that it held.[21] Both loans were made at the lowest interest rate

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[16] *Id.*

[17] *Id.* ¶ 16; *see also id.* Ex. A, Art. 1, § 1.2(a).

[18] *Id.* Ex. A., Art. 5, § 5.2(r).

[19] *Id.* ¶ 17.

[20] Bernstein Dep. 48-49.

[21] Bernstein Dep. 47. In 2007, some assets of the Plaintiff were transferred, or decanted, into the newly formed Special Asset Trust. The Special Asset Trust is not the Plaintiff in this action. *Id.* 32.

allowable by the Internal Revenue Service and both loans were ultimately repaid.[22]

13. Bernstein occasionally communicated with Kaestner regarding Plaintiff. Kaestner was provided an accounting of the Trust,[23] and received legal advice regarding the Trust from Bernstein and his firm.[24] Additionally, Bernstein met with Kaestner and her husband in New York to discuss the Trust, whether the Kaestners desired to receive income distributions, and certain investments the Trust held.[25]

14. During the tax years at issue, 2005 to 2008, Defendant taxed Plaintiff on the income accumulated in the Trust during each year, although no income was distributed to a North Carolina beneficiary.[26] Plaintiff seeks refunds totaling in excess of $1.3 million, including $79,634.00 paid for the year 2005; $106,637.00 paid for 2006; $1,099,660.00 paid for 2007; and $17,241.00 paid for 2008.[27] Plaintiff's request for a refund was denied on February 11, 2011.[28] Although Plaintiff's Complaint seeks return of penalties paid on these amounts, no penalties were paid to the State of North Carolina after Plaintiff received a complete waiver of these fees.[29]

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[22] *Id.* at 47-49, 52.
[23] Bernstein Dep. 60.
[24] *Id.* at 56-57.
[25] *Id.* at 64-73.
[26] Bernstein Aff. ¶¶ 19, 21.
[27] *Id.* ¶ 22.
[28] *Id.* ¶ 23.
[29] Koonce Aff. ¶¶ 4-5.

Discussion

15. In this lawsuit, Plaintiff challenges the Department's authority to impose income taxes on the Trust during the years 2005–2008 pursuant to G.S. § 105-160.2. For purposes of context, G.S. § 105-160.2 provides, in pertinent part, as follows:

> The tax imposed by this part applies to the taxable income of estates and trusts as determined under the provisions of the Code . . . . 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.

16. In actuality, the only part of G.S. § 105-160.2 that is at issue in this action is the clause of the above-quoted language that provides for a trust to pay taxes on income "that is for the benefit of a resident of this State."[30]

17. Plaintiff alleges that Section 105-160.2 is unconstitutional on its face and as applied under the Due Process and Commerce Clauses of the United States Constitution, and a violation of

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[30] Compl. ¶ 2.

Article I, Section 19 of the North Carolina Constitution.[31] "When a constitutional question is properly presented, it is the duty of the court to ascertain and declare the intent of the framers of the Constitution and to reject any legislative act which is in conflict therewith." *Mitchell v. N. C. Indus. Dev. Fin. Auth.*, 273 N.C. 137, 144 (1968); *see also Williams v. Blue Cross Blue Shield*, 357 N.C. 170, 183 (2003) (noting this duty and striking down a local act as unconstitutional).

18. "In challenging the constitutionality of a statute, the burden of proof is on the challenger, and the statute must be upheld unless its unconstitutionality clearly, positively, and unmistakably appears beyond a reasonable doubt or it cannot be upheld on any reasonable ground." *Guilford Cnty Bd. of Educ. v. Guilford Cnty Bd. of Elections*, 110 N.C. App. 506, 511 (1993). When questioning the authority in court of the State to exert its taxing power, "only clear and demonstrated usurpation of power will authorize judicial interference with legislative action." *Railway Express Agency, Inc. v. Maxwell*, 199 N.C. 637, 642 (1930) (quoting *Green v. Frazier*, 253 U.S. 233, 239 (1920)). As the Supreme Court of the United States has explained, "[a] state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized

[31] Compl. ¶¶ 40, 47, and 49.

society." *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444 (1940).

19. The parties agree that the dispositive facts necessary for the Court to decide this case are not in dispute. The question for determination is whether Defendant has the authority under the United States and North Carolina Constitutions to tax Plaintiff on the undistributed income of the Trust based solely upon the beneficiaries' residence in this State.[32]

Due Process Challenge

20. Plaintiff challenges §105-160.2 under the Due Process Clause of the United States Constitution and the Law of the Land Clause of the North Carolina Constitution. The Fourteenth Amendment to the United States Constitution provides that no state shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend XIV, § 1. Article I, Section 19 of the Constitution of North Carolina guarantees due process rights by providing that no person shall be "in any manner deprived of his life, liberty, or property, but by the law of the land." The North Carolina Supreme Court has noted 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 (2004). Accordingly, these provisions are, "for all practical purposes, the same under both the State and Federal Constitutions." *Leonard v.*

[32] Def.'s Br. Supp. Mot. Summ. J. 19-20.

Maxwell, 216 N.C. 89, 93 (1939). Under either constitution, "a State's 'exaction of a tax constitutes a deprivation of property' subject to the safeguards of the Due Process Clause." *Delhaize Am., Inc. v. Lay*, 222 N.C. App. 336, 343 (2012) (quoting *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990)). Accordingly, Plaintiff's due process challenge to the statute under the United States and North Carolina Constitutions may be analyzed together.

21. When a state seeks to impose a tax, the Due Process Clause requires: (1) "some definite link, some minimum connection, between a state and a person, property or transaction it seeks to tax;" and (2) "that the income attributed to the State for tax purposes . . . be rationally related to values connected with the taxing state." *Quill v. North Dakota*, 504 U.S. 298, 306 (1992). Under the first requirement, courts consider whether a taxed entity's "connections with a State are substantial enough to legitimate the State's exercise of power over" it. *Id.* at 312. Where the taxed entity has no physical presence in a state, the entity must "purposefully avail itself of the benefits of an economic market in the forum state." *Id.* at 307. This requirement ensures that the taxed entity is given "fair warning that *its activity* may subject it to the jurisdiction of a foreign sovereign." *Id.* at 308 (emphasis added). Under the second requirement, courts analyze "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *J. C. Penney Co.*, 311 U.S. at 444.

22. The focus of the due process inquiry must be on the entity being called upon to pay taxes under

G.S. §105-160.2; here, Plaintiff itself.[33] Accordingly, the Court must scrutinize Plaintiff's contacts with, and relationship to, North Carolina, as well as benefits conferred upon it by North Carolina, to determine the State's authority to tax Plaintiff.

23. Turning to Plaintiff's contacts with the State of North Carolina, nothing in the record indicates, and Defendant does not argue, that Plaintiff maintained any physical presence in North Carolina during the tax years at issue. The undisputed evidence in this matter shows that Plaintiff never held real property located in North Carolina, never owned personal property located in North Carolina, and never invested directly in any North Carolina based investments.[34] The record also indicates that no trust records were kept or created in North Carolina, or that the trust could be, in any other manner, said to have a physical presence in the State. Moreover, because the trustee's usual place of business where trust records were kept was outside the State, it is

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[33] The parties do not dispute that the Plaintiff Trust, and not Kimberly Kaestner or her children, is the taxed entity. *See Anderson v. Wilson*, 289 U.S. 20, 27 (1933) (holding "the law has seen fit to deal with this abstraction [a trust] for income tax purposes as a separate existence").

[34] The Court recognizes that, during the tax years at issue, Plaintiff held investments in entities that, in turn, made investments that may have been related to North Carolina, incurring losses of less than $2.50 in the tax years at issue. However, such an indirect connection is not a sufficient contact to satisfy due process standards. *See Residuary Trust A. v. Director*, 27 N.J. Tax 68, 76-77 (2013) (holding that a trust did not own New Jersey assets simply by investing in an entity that owned New Jersey assets).

clear from the record that Plaintiff's principal place of administration was not North Carolina.[35]

24. Defendant contends, however, that the situs, or residence, of the trust is irrelevant as many of its assets are "stored in the cloud" and therefore do not exist in tangible form.[36] However, the Court notes that other courts have treated the situs of intangible assets such as securities as the physical location of the owner or at which the physical certificates are maintained. *See Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 92 (1929) ("Intangible personal property may acquire a taxable situs where permanently located, employed and protected;" and cases cited therein); *Hanson v. Denckla*, 357 U.S. 235, 247 n. 16 (1958). These items being located, held, and protected outside North Carolina, the Court finds Defendant's position unpersuasive.

25. Since Plaintiff has no physical presence in the State, the Court must determine whether Plaintiff has "purposefully availed" itself of the benefits, economic and otherwise, and laws of North Carolina. As noted above, it is the taxed entity that must direct its actions towards the taxing state. Such actions could include "the keeping of tangible or intangible personality within a state," "the use and sale of property," and incorporation in, or permission to conduct business granted by, a state. *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 345

[35] *See* G.S. § 36C-1-103 (defining the principal place of administration for a trust); *see also* G.S. § 36C-2-203(d) (recognizing a distinction between trusts administered inside and outside North Carolina).
[36] *See* Def.'s Br. Supp. Mot. Summ. J. 7-9.

(1954). More specific to a trust, the maintenance of offices, the ownership of assets, or the transaction of business in a state might provide sufficient minimum connection to tax the trust. *Hanson*, 357 U.S. at 251.

26. Defendant concedes that the only "connection between the [Plaintiff] Trust and North Carolina in the case at hand is the residence of the beneficiaries." [37] Defendant contends, however, that Kaestner and her three children have "made North Carolina their home, residence and domicile" since 1997 and that "all of the income earned by the Trust in the years at issue was for the benefit of Ms. Kaestner and her three children." [38] Defendant argues that because the beneficiaries had an equitable interest in Plaintiff's assets, and could potentially have received future distributions, the Trust should be taxable in North Carolina based on their residence in the State.[39] The Court finds Defendant's position unpersuasive for two reasons.

27. First, Defendant's position conflates the beneficiaries' contact with North Carolina with that of the Trust. As noted above, trusts and their beneficiaries are separate legal entities. *See Anderson*, 289 U.S. at 27 (recognizing that, for income tax purposes, trusts are a "separate existence"). Accordingly, Plaintiff's contacts with North Carolina are relevant here, but not those of its beneficiaries. Nothing in the record indicates that Plaintiff itself ever engaged in the sort of

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[37] *Id.* at 7, 9.
[38] *Id.* at 7.
[39] *Id.* at 9-11.

"purposeful availment" that would subject it to taxation in North Carolina. *See Miller Brothers Co.*, 347 U.S. at 345 (recognizing actions that would constitute sufficient contact to permit taxation by the State of Maryland).

28. Second, Defendant's position ignores the undisputed facts that Kaestner and her children had no control over Plaintiff's assets or ability to generate income from those assets, and had no authority to compel Plaintiff to distribute income earned by the Trust. In North Carolina, the beneficiaries of a trust have no legal interest in the trust's current or future income unless and until they are distributed. *Sabine v. Gill*, 229 N.C. 599, 605 (1948) (trust income "is an intangible which belongs to the trust estate and becomes [the beneficiary's] only by distribution"). Accordingly, the Court concludes that even if the beneficiaries' interest in the Trust's income and assets constitutes an "equitable interest," as Defendant contends, such a remote interest does not provide a sufficient nexus between the Trust and the State of North Carolina such that the latter can tax the income of the former.

29. Defendant also disputes "Plaintiff's unqualified characterization" that the Trustee managed Plaintiff without any consultation with Kaestner.[40] Defendant contends that Kaestner was provided information about the Trust from Bernstein as trustee, received advice concerning the Trust, and even received two loans from the Trust. This contact with the Trustee, Defendant appears to contend, constitutes a contact between

[40] Def.'s Br. Opp. Pl.'s Mot. Summ. J. 12.

Plaintiff and the State and further demonstrates that Kaestner had some input in, and thus some control over, operations of the Trust.

30. While the record indicates that Kaestner received information concerning the Trust and received one direct loan from the Trust, [41] it remains undisputed that the actual control of Plaintiff remained with the Trustee in his absolute discretion.[42] Moreover, such infrequent contact as reflected in the record, [43] contact driven by the beneficiary and not Plaintiff, cannot, as a matter of law, constitute sufficient contact of Plaintiff with the State such that all of Plaintiff's undistributed income is subject to taxation in North Carolina.

31. Under these circumstances, the Court does not believe that the residency of the beneficiaries in North Carolina, standing alone, can be viewed as the Trust's "purposeful" activity in this State. *Safe Deposit & Trust Co.*, 280 U.S. at 91; *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964) ("[T]he imposition of a tax in the State in which the beneficiaries of a trust reside, on securities in the possession of the trustee in another State, to the control or possession of which the beneficiaries have no present right, is in

[41] In addition to the loan to the Special Asset Trust that, Defendant contends, was for Kaestner's benefit. *See supra*, ¶ 12.

[42] *See* Bernstein Aff. ¶ 16 (noting that the Trustee never consulted with the beneficiaries concerning investment decisions, and that Trustee had, at all relevant times, the sole discretion to make all investment decisions).

[43] *See* Bernstein Dep. 81-84 (describing infrequent, "maybe once a year," meetings with the Kaestners).

violation of the Fourteenth Amendment").[44] Ultimately, Plaintiff has "clearly, positively, and unmistakably" established that it did not have contacts of a sufficient quality or quantity to be subjected to taxes by the State of North Carolina and to satisfy the requirements of due process.

32. Plaintiff also has established that the tax levied on the Trust fails to satisfy the second requirement of the due process analysis because the income attributed to North Carolina for tax purposes is not rationally related to values connected with North Carolina. *See Quill*, 504 U.S. at 306. Under this prong, courts must analyze "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *J. C. Penney*, 311 U.S. at 444. The Supreme Court distilled the analysis even further: "The simple but controlling question is whether the state has given anything for which it can ask return." *Id.* As discussed above, the undisputed evidence shows that Plaintiff, as a taxed entity distinct from its beneficiaries, has not done anything to seek out the protection, opportunities, and benefits conferred by North Carolina, and North Carolina has not provided anything to the Trust for which it can ask return.

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[44] To the extent Defendant contends that Kaestner's or her children's activities in North Carolina constitute the Trust's activities, their activities clearly cannot satisfy the minimum contacts required by due process. *Hanson*, 357 U.S. at 255. ("The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum state.")

33. Defendant does not expressly address this second requirement of the due process analysis. Instead, Defendant contends that *Quill* did not create a rigid test for determining whether due process standards have been met. Defendant argues that the relevant inquiry is whether the taxed entity "had minimum contacts with the jurisdiction 'such that maintenance of the suit does not offend traditional notions of fair play and substantial justice'" and whether the taxed entity's contacts with the forum made it reasonable for the jurisdiction to impose the tax. [45] Even applying these standards, however, the tax levied against Plaintiff does not meet due process requirements. As discussed above, the entity that is subjected to the taxes still must have sufficient *contacts* with the state that make it fair and reasonable that the state impose the taxes at issue. Again, the only contact that Plaintiff has with North Carolina is the presence in the State of beneficiaries who hold, at most, only equitable interests in the Trust. Not only have the beneficiaries not enjoyed any distribution from the Trust, it is undisputed that Kaestner and her children cannot compel distributions, have no right to control the assets held by Plaintiff and have had no influence over the amount of income generated by Plaintiff. While the presence of Kaestner and her children in North Carolina may provide *some* contact with the State, absent any other contact by Plaintiff, it does not provide the minimum contacts necessary to satisfy the due process requirement of the United States and North Carolina Constitutions.

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[45] Def.'s Reply to Pl.'s Resp. 6.

34. Defendant relies heavily on two decisions from other states, *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), and *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999). In *McCulloch*, a beneficiary residing in California received a terminal distribution in 1951 from a non-resident trust. The distribution included the trust assets and the income earned and accumulated in the trust during the years 1946-1950. *Id.* at 415. California taxed the beneficiary for the income earned by the trust during the five years prior to the distribution and for which the trust had not paid taxes to California. *Id.* The beneficiary challenged the assessment of the tax on the income earned by the trust on due process grounds. The Supreme Court of California held that the tax met due process requirements because it concluded that the beneficiary's "residence [in California] confers the essential 'minimum connection' necessary for due process of law." *Id.* at 419. The Court reasoned 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 the accumulated income." *Id.*

35. As a preliminary matter, the *McCulloch* case has features which distinguish it from this case. In *McCulloch*, the taxed beneficiary was also a trustee of the trust. While not the basis for its holding, the Court explained that "[n]o possible doubt attaches to California's constitutional power to tax plaintiff as a trustee. His secondary role as trustee reinforces the independent basis of taxing plaintiff

as beneficiary." *Id.* at 421. Ms. Kaestner and her children are not trustees of the Trust.

36. In addition, the precise question before the court in *McCulloch* was California's right to tax the beneficiary for the trust's accumulated income upon a distribution, not the direct taxation of the trust itself. *McCulloch*, 390 P.2d. at 414-15, 419, 421. The court stated:

> [T]o hold that California could not levy this tax upon the beneficiary when the trust is distributed to him would expose this state to serious impediments in the collection of its taxes. The purpose of section 18106 of the Revenue and Taxation Code in imposing upon the beneficiary at the time of the trust distribution his personal obligation to pay taxes due, but unpaid, by the trust is to avoid the difficulties which the state might otherwise encounter in attempting to enforce tax collection directly against foreign trustees.

Id. at 420. Here, of course, the tax is not being assessed against Kaestner or her children, and is not being collected upon a distribution.

37. Ultimately, however, this Court simply does not find *McCulloch* persuasive and reaches a different result. The Court concludes that the beneficiary's residence in North Carolina, standing alone, is not a sufficient contact by the Trust with this State to support the imposition of the tax at issue, and that the benefits enjoyed by Ms. Kaestner and her children as residents of North Carolina are not "protection, opportunities, and

benefits" conferred upon the Trust. *J.C. Penney*, 311 U.S. at 444.

38. In *Gavin*, the Supreme Court of Connecticut reached a similar result to *McCulloch*, concluding "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 non- contingent beneficiary because it gives her the same protections and benefits." *Gavin*, 733 A.2d at 802. [46] Like *McCulloch*, the facts of *Gavin* provide grounds for distinguishing it from this matter. In *Gavin*, the settlor of the trust was also a Connecticut domiciliary when he created the trust and, accordingly, the trust was a Connecticut "resident *inter vivos* trust." *Id.* at 787, 789.[47] In this case, the Settlor of the Trust was a resident of New York, and there is no North Carolina statute making the Kaestner Trust a resident trust of this State.

39. In reaching its conclusion, the court in *Gavin* also stated that it was "not persuaded that . . . *Safe Deposit & Trust Co. v. Virginia* . . . is still good law" because the holding was based, in part, on the potential that the trust could be subjected to "double taxation," that is, taxation in more than one state. *Id.* at 802. First, *Safe Deposit & Trust*

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[46] In *Gavin*, the Court expressly relied upon *McCulloch* as supporting its holding. *Gavin*, 733 A.2d at 803.

[47] Connecticut General Statute § 12-701(a)(4)(D) provided that a resident *inter vivos* trust is "a trust, or portion of a trust, consisting of the property of (i) a person who was a resident of this state at the time the property was transferred to the trust if the trust was then irrevocable."

Co. v. Virginia has not been expressly overruled. Second, a close reading of *Safe Deposit & Trust Co. v. Virginia* demonstrates that the Court considered many of the same factors present in this case in reaching its holding. Central to the analysis in *Safe Deposit & Trust Co.*, the Court noted that, as is the case here, the possessor of the legal title to the securities held in trust in that case resided outside of the state imposing the tax on those assets, and the beneficiaries had no "present right to their enjoyment or power to remove them." *Safe Deposit & Trust Co.*, 280 U.S. at 92. Accordingly, the Court does not agree that *Safe Deposit & Trust Co.* is no longer "good law," as characterized by the *Gavin* court, but remains, at a minimum, instructive as to the due process implications of taxing a trust with such bare connections to the taxing State.

40. For the same reasons stated above, the Court concludes that the beneficiary's residence in North Carolina, standing alone, is not a sufficient contact by the Trust with this State to support the imposition of the tax at issue, and declines to follow the reasoning in *Gavin*.

41. Accordingly, the Court concludes that the portion of G.S. § 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" violates the Due Process Clause of the United States Constitution and Article I, Section 19 of the North Carolina Constitution as applied to Plaintiff in this case where the only basis for imposition of the taxes is the beneficiaries' residence in the State of North Carolina.

Commerce Clause Analysis

42. Plaintiff also challenges the constitutionality of G.S. § 105-160.2 under the Commerce Clause of the United States Constitution.[48] Contained in Article 1, Section 8, that clause provides Congress with the authority to "regulate Commerce . . . among the several States."[49] As the Supreme Court of the United States has recognized, that Clause "'by its own force' prohibits certain state actions that interfere with interstate commerce." *Quill v. N. Dakota*, 504 U.S. 298, 309 (1992) (quoting *S. Carolina State Highway Dept. v. Barnwell Bros., Inc.*, 303 U.S. 177, 185 (1938)). This "negative sweep" of the Commerce Clause, or dormant Commerce Clause, has been interpreted to place specific limitations on the ability of states to levy taxes on interstate commerce and activity. *Quill*, 504 U.S. at 309.

43. In *Complete Auto Transit, Inc. v. Brady*, the Supreme Court articulated the now well-established four prong analysis for determining the constitutionality of a tax under the Commerce Clause. 430 U.S. 274, 279 (1977); *see also Goldberg v. Sweet*, 488 U.S. 252, 259-260 (1989); *Quill*, 504 U.S. at 311. A state tax withstands scrutiny under the Commerce Clause if: (1) it is applied to an activity with a substantial nexus to the taxing state; (2) it is fairly apportioned so as to tax only the activities connected to the taxing state; (3) it does

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[48] For a thorough discussion of the distinction between the constitutionality of a tax under the Due Process Clause and the Commerce Clause, *see Quill v. N. Dakota*, 504 U.S. 298 (1992).

[49] U.S. Const. art. I, § 8, cl. 3.

not discriminate against interstate commerce; and (4) it is fairly related to services provided by the state. "To pass constitutional muster, *all* four prongs must be satisfied and the failure to meet any one of these requirements renders the tax unconstitutional." *McNeil v. Commonwealth of Pa.*, 67 A.3d 185, 192 (Pa. Commw. Ct. 2013) (citing *Complete Auto Transit, Inc.*, 430 U.S. at 279) (emphasis in original). Because the Court, largely for reasons already discussed above, finds that the application of G.S. § 105-160.2 to Plaintiff fails to satisfy the first and fourth prongs of *Complete Auto*, the Court need not address prongs two and three of that test.

44. The *Complete Auto* test first requires that the activity taxed have a "substantial nexus" to the taxing State. The Supreme Court has explained that, although similar to the minimum contacts required under a due process analysis, the "substantial nexus" required under the Commerce Clause reflects a concern over the impact of State regulation on the national economy and, therefore, requires more than "minimum contacts" with the taxing State. *Quill v. N. Dakota*, 504 U.S. 298, 312-13 (1992). Additionally, the Supreme Court has specifically noted that an entity "may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 313.

45. Here, the Court already has found that the Trust itself, as a separate legal entity from its beneficiaries, lacked sufficient "minimum contacts" with North Carolina to satisfy the Due Process

Clause. Similarly, the mere presence of the beneficiaries in North Carolina, while some contact with the State, is not a "substantial nexus" between the Trust and the State of North Carolina. As noted above, all Trust records were compiled and retained outside of North Carolina, all real or personal property held by the Trust was located outside North Carolina, and all income generated by the Trust was generated from investments located outside North Carolina.[50] Accordingly, both the Trust and the income it generated lacked a substantial nexus with this State sufficient to satisfy the *Complete Auto* test.

46. Additionally, the fourth prong of the *Complete Auto* test requires that the tax imposed be fairly related to services provided by the State. This prong ensures that "a State's tax burden is not placed upon persons who do not benefit from services provided by the State." *Goldberg*, 488 U.S. at 266-67 (1989). For this reason, the focus of this prong is on "the presence and activities *of the taxpayer within the State*." *Id.* at 266 (emphasis added). Here, as noted above, Plaintiff had no presence in North Carolina.[51] Plaintiff engaged in no activity in the State of North Carolina; it did not make investments in North Carolina, it made no distributions to North Carolina residents, and it did not maintain any records in North Carolina.[52]

47. On this point, the recent decision of the Commonwealth Court of Pennsylvania in *McNeil v. Commonwealth*, a case factually similar to the

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[50] *See supra* ¶ 23.
[51] *Id.*
[52] *Id.*

present case, is instructive. In *McNeil*, Pennsylvania "assessed Pennsylvania income Tax and interest on all of the income of two inter vivos trusts which are located in, administered in, and governed by, the law of Delaware and which had no Pennsylvania income or assets" on the basis that the trusts' discretionary beneficiaries and settlor were Pennsylvania residents. 67 A.3d at 187-88. The trusts had no obligation to pay any distributions to the beneficiaries and the beneficiaries had no current or future right to the income or assets of the trusts. *See id.* at 194. Pennsylvania law classified the trusts as resident trusts based on the residency of the settlor and taxed the trusts on all of their income. *Id.* at 187, 190. The Court concluded that the tax violated three prongs of the *Complete Auto* test because (a) the residency of the beneficiaries and settlor did not establish a substantial nexus between Pennsylvania and trusts, (b) the tax was not fairly apportioned as the trust had no Pennsylvania income or assets and the trustees had no presence in Pennsylvania, and (c) the tax was not fairly related to services provided by Pennsylvania as the trusts had no physical presence in Pennsylvania, none of their income was derived from Pennsylvania sources, none of their assets or interests were located in Pennsylvania, and they were established under and were governed by Delaware law. *Id.* at 192-97. To be sure, the beneficiaries themselves, as residents of Pennsylvania, received benefits from Pennsylvania; nonetheless, the *McNeil* court made clear that it was the trust that was subject to taxation, not the beneficiaries themselves. *Id.* at 198 (noting the beneficiaries will pay Pennsylvania tax on any distributions they receive from the trusts). Ultimately, the court in *McNeil* recognized that, although the beneficiaries were provided a benefit from the Commonwealth of Pennsylvania, because the plaintiff trusts themselves "d[id] not benefit from Pennsylvania's . . . economic markets, . . . courts, and laws," the fourth prong of *Complete Auto* was not satisfied. *Id.* at 197-98.

48. Similarly, notwithstanding the absence of the Trust's meaningful contact with or activity in North Carolina, Defendant argues that this prong is satisfied because "North Carolina provides the beneficiaries with a civilized society . . . [and] the environment for the enjoyment of the Trust, whether assets are distributed now or later."[53] However, as noted above, the *Complete Auto* test examines the activities "of the taxpayer" in the taxing State. *Goldberg*, 488 U.S. at 266. Defendant has only taxed Plaintiff, not the beneficiaries or any North Carolina resident. Accordingly, the Court is limited to examining the benefit conferred by the State on Plaintiff as a separate legal entity from the beneficiaries. *See Anderson*, 289 U.S. at 27. Unlike the beneficiaries, Plaintiff does not benefit from any services or legal framework provided by the State of North Carolina. *See McNeil*, 67 A.3d at 197-98. Similarly, the Court concludes that application of G.S. § 105-160.2 to Plaintiff does not satisfy the fourth prong of *Complete Auto*.

49. Ultimately, because the application of G.S. § 105-106.2 fails to satisfy the first or fourth prongs of the *Complete Auto* test, the Court concludes that

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[53] Def.'s Br. Supp. Mot. Summ. J. 30.

the portion of G.S. § 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" violates the Commerce Clause of the United States Constitution and Article I, Section 19 of the North Carolina Constitution as applied to Plaintiff in this case where the only basis for imposition of the taxes is the beneficiaries' residence in the State of North Carolina.

Conclusion

50. Although Plaintiff must satisfy a high burden to prove that a State statute is unconstitutional, North Carolina case law has shown that such a burden is not insurmountable. *See McIntyre v. Clarkson*, 254 N.C. 510 (1961) (holding statute at issue constitutionally invalid where challenger showed the statute's unconstitutionality beyond a reasonable doubt). *Accord Board of Managers James Walker Memorial Hospital v. Wilmington*, 237 N.C. 179, 189 (1953); *Rockford-Cohen Group, LLC v. N.C. Dep't of Ins.*, N.C. App. , 749 S.E.2d 469 (2013).

51. Ultimately, after a thorough review of the record in this action and consideration of the arguments of the parties, the Court concludes that Plaintiff has shown, beyond a reasonable doubt, that the portion of G.S. § 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" is unconstitutional under the Due Process and Commerce Clauses of the United States Constitution and Article 1, Section 19 of the North Carolina Constitution as applied to Plaintiff in this case where the only basis for imposition of the

taxes is the beneficiaries' residence in the State of North Carolina. For the reasons stated above, it appears to the Court that Plaintiff's Motion for Summary Judgment should be GRANTED, and Defendant's Motion for Summary Judgment should be DENIED.

THEREFORE, IT IS ORDERED that:

52. Plaintiff's Motion for Summary Judgment is GRANTED. Defendant shall refund any and all taxes and penalties paid by Plaintiff pursuant to G.S. § 105-160.2, with interest.

53. Defendant's Motion for Summary Judgment is DENIED.

This the 23rd day of April, 2015.