No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of North Carolina

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

INTRODUCTION

The Trust does not deny that this case presents an important and unresolved question: whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency. Instead, the Trust makes three unsuccessful arguments in opposition to the petition.

First, the Trust tries to explain away the direct split among the nine state courts that have considered the question presented. The Trust suggests that there is no conflict because each of these nine decisions is supposedly distinguishable on its facts.

The Trust's approach misses the point: Each of the cited cases decided whether a trust beneficiary's in-state residency permits a state to tax a trust. None of those decisions tethered its legal conclusion to the factual distinctions that the Trust attempts to make. Thus, the Trust's factual distinctions do not diminish the direct split that justifies this Court's review.

Second, the Trust argues that this case is a poor vehicle. Those arguments fail as well.

For example, the Trust is mistaken when it claims that this case would affect only a few states. Six states (including North Carolina) assess taxes solely on the basis of a beneficiary's in-state residency. The validity of those states' trust-taxation statutes hinges on the question presented. In addition, another five states rely on a beneficiary's in-state residency plus other connections with the taxing state. Upholding North

Carolina's statute here would validate the statutes in those states as well. Thus, the question presented affects at least eleven states, as well as any other state that may wish to consider a similar trust-taxation policy in the future.

The Trust also argues that this case is a poor vehicle because it "would likely return" to this Court on Commerce Clause grounds—an independent issue that North Carolina's appellate courts did not reach.

This Court often grants certiorari in cases where the courts below did not address every issue. In those instances, the Court simply grants certiorari on the question presented and, if it rules in the petitioner's favor, remands for the lower courts to consider the remaining issues. The Trust offers no answer for why that common procedural posture presents a problem here.

Finally, the Trust argues the merits. Its rigid, presence-focused arguments, however, confirm the need for this Court to modernize its trust-taxation jurisprudence. And regardless of which side is right on the merits, certiorari is needed to resolve the state-court split that the petition describes.

In sum, the petition presents an important and unresolved constitutional issue that has divided nine state courts. The Court should grant the petition to resolve the conflict.

ARGUMENT

I. There is a direct split among nine state courts on the question presented.

Nine state courts are divided on whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency. The petition recounts the conflicting conclusions on each side of the split. Pet. 9–12.

The Trust's only response is to stress minute factual distinctions among the nine cited decisions. That approach fails, because each of those decisions squarely addressed the question presented, without tethering its decision to the factual distinctions that the Trust attempts to make.

The Trust begins by arguing that the Connecticut Supreme Court's decision in *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), is inapposite because the "beneficiary's residency was not the sole contact relied upon by the Connecticut Supreme Court." Opp. 17. But the Trust ignores *Gavin*'s central legal conclusion: The beneficiary's residence is the "critical link" justifying taxation. 733 A.2d at 802 n.25; *see also* Pet. 10. That conclusion directly conflicts with the conclusion reached by the state courts on the other side of the split (Michigan, Minnesota, New Jersey, New York, and North Carolina), each of which considered the beneficiary's residence irrelevant. *See* Pet. 10–12.

Likewise, the Trust tries to dissect the underlying facts of *Linn v. Department of Revenue*, 2 N.E.3d 1203

(Ill. App. Ct. 2013), and *Westfall v. Director of Revenue*, 812 S.W.2d 513 (Mo. 1991), arguing that those cases involved jurisdictional contacts that are not present here. *See* Opp. 12–14, 17–18. But those other facts do not change the courts' key legal conclusions on the due-process consequences of a beneficiary's in-state residency.

In *Linn*, for example, the Illinois Appellate Court relied on *Gavin*'s holding that a beneficiary's residence is the "critical link" that justifies taxation. 2 N.E.3d at 1209. Likewise, in *Westfall*, the Missouri Supreme Court relied on the "domicile of the beneficiaries" within the taxing state as a factor that "support[s] imposition of an income tax on trust income." 812 S.W.2d at 514. Nothing in the Trust's brief reconciles those legal conclusions with the other side of the split.

Next, the Trust claims that the California Supreme Court's decision in *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), is irrelevant because it upheld a tax on a beneficiary, not on a trust. Opp. 15–16.[1] But the *McCulloch* court allowed California to tax the beneficiary only after the court decided that taxing the trust itself based on the in-state residency of the beneficiary satisfied due process. 390 P.2d at 417–19. It did so, moreover, on the rationale that a beneficiary's state of residence can tax the trust because "that state

[1] The Trust also emphasizes that the *McCulloch* beneficiary doubled as one of the trustees. Opp. 16. But the beneficiary's dual roles played no part in the court's holding, as the court made clear. *McCulloch*, 390 P.2d at 421 (describing the trustee's role as an "independent basis" for taxation).

renders to the beneficiary . . . protection incident to his eventual enjoyment of such accumulated income." *Id.* at 419.

Finally, the Trust takes issue with the cases on the other side of the split. Opp. 10–14. It dissects the underlying facts of those cases, arguing that they did not squarely address the question presented. The Trust is in no position to make this argument: It relied on these cases in the courts below.[2]

Regardless, the Trust's attempt to reclassify these cases now is flawed. Each of these cases, notwithstanding their slight factual differences, held that the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency. *See Blue v. Dep't of Treasury*, 462 N.W.2d 762, 764 (Mich. Ct. App. 1990) (holding that only the presence of the "trustee [or] trust property . . . within the state" would justify taxation of the trust); *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323, 331 (Minn. 2018), *petition for cert. filed*, No. 18-664 (Nov. 15, 2018) ("[T]he Minnesota residency of [the] beneficiary . . . does not establish the necessary minimum connection to justify taxing the Trusts' income."); *Potter v. Taxation Div. Dir.*, 5 N.J. Tax 399, 405 (1983) ("The fact that . . . beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New

---

[2] *See* Plaintiff-Appellee's New Brief at 31, 38–39, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018) (No. 307PA15-2); Plaintiff-Appellee's Brief at 14–17, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 789 S.E.2d 645 (N.C. Ct. App. 2016) (No. 15-896).

Jersey to tax undistributed trust income."); *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490, 491 (N.Y. 1964) (holding that "the imposition of a tax in the State in which the beneficiaries of a trust reside" on income earned in another state violates due process); *see also* Pet. 10–12 (describing these cases in detail).

In sum, the factual distinctions that the Trust offers are unconnected to the relevant holdings of the nine state courts that have split on the question presented. Nothing in the Trust's brief diminishes that direct split.

II. This case is an ideal vehicle for resolving the question presented.

The Trust argues that four features of this case make it a poor vehicle for resolving the question presented. Those arguments fail as well.

First, the Trust argues that this case has "a unique fact pattern." Opp. 19. But the "unique" fact that the Trust identifies is the Department's emphasis on the trust beneficiary's in-state residency, as opposed to other contacts between the Trust and North Carolina. Indeed, that is precisely why this case is an ideal vehicle: It presents the beneficiary's in-state residency in clean form, allowing the Court to resolve the question presented without the need to consider other types of jurisdictional contacts.[3] Thus, the reason that

[3] The Trust acknowledges that this case "presents only the narrow question" of whether taxing the Trust "solely on the

the Trust believes this case is "unique" actually makes it a clean vehicle for deciding the question presented.

Next, the Trust suggests that a decision on the question presented would affect only a few states. Opp. 20–21. The Trust is mistaken.

Six states (including North Carolina) assess taxes solely on the basis of a beneficiary's in-state residency.[4] The validity of those states' trust-taxation statutes hinges on the question presented here.

In addition, another five states rely on the beneficiary's in-state residency plus other contacts with the taxing state.[5] Upholding North Carolina's statute here would validate the statutes in those states as well. After all, if this Court were to hold that a beneficiary's in-state residency satisfies due process, that holding would imply that a beneficiary's in-state residency *plus additional* connections with the taxing state would also satisfy due process.

Thus, the question presented affects at least eleven states, as well as any other state that may wish

---

presence of an in-state beneficiary violates the Due Process Clause." Opp. 7. That admission undermines the Trust's argument elsewhere in its brief that this case is "fact-bound." *Id.* at 1.

4 Those states (other than North Carolina) are California, *see* Cal. Rev. & Tax. Code § 17742(a); Georgia, *see* Ga. Code Ann. § 48-7-22(a)(1)(A); Montana, *see* Mont. Admin. R. 42.30.101(16); North Dakota, *see* N.D. Admin. Code 81-03-02.1-04; and Tennessee, *see* Tenn. Code Ann. § 67-2-110(a).

5 Those states are Alabama, *see* Ala. Code § 40-18-1(33); Connecticut, *see* Conn. Gen. Stat. Ann. § 12-701(a)(4); Missouri, *see* Mo. Rev. Stat. § 143.331(1)(b); Ohio, *see* Ohio Rev. Code Ann. § 5747.01; and Rhode Island, *see* 44 R.I. Gen. Laws § 44-30-5(c).

to consider a new trust-taxation policy in the future. Pet. 12–15 (describing the consequences for other states on future tax policy). For just these eleven states, moreover, billions of dollars of state revenue is at stake—a factor that the Trust does not address.

The Trust also suggests that this case is a poor vehicle because it "would likely return on Commerce Clause grounds if the Department was successful." Opp. 23. That argument fails for two reasons.

First, the existence of an unresolved issue that is independent from the question presented is no impediment to this Court's review. To the contrary, it is a common pattern in cases where the Court has granted certiorari. When this pattern arises, the Court simply grants certiorari on the question presented and, if it rules in the petitioner's favor, remands for the lower court to consider the remaining issue. *See, e.g.*, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018); *Fitzgerald v. Barnstable Sch. Comm.*, 555 U.S. 246, 260 (2009); *Wash. State Grange v. Wash. State Repub. Party*, 552 U.S. 442, 458 n.11 (2008); *Envt'l Def. v. Duke Energy Corp.*, 549 U.S. 561, 581–82 (2007); *Whitman v. Dep't of Transp.*, 547 U.S. 512, 515 (2006); *Muehler v. Mena*, 544 U.S. 93, 102 (2005); *Devenpeck v. Alford*, 543 U.S. 146, 156 (2004); *Meyer v. Holley*, 537 U.S. 280, 291 (2003). Thus, the Trust's Commerce Clause claim has no bearing on whether this case is an appropriate vehicle.

In addition, the Trust's prediction about a return trip to this Court is improbable. Now that the Court has eliminated the physical-presence rule, *see Wayfair,* 138 S. Ct. at 2099, the Commerce Clause issue in this case involves a straightforward application of this Court's precedents. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Thus, even if the possibility of a return trip to this Court mattered here, the Trust would have no basis for suggesting that a return trip would be "likely." Opp. 23.

Finally, the Trust insists that no modernization of the Court's precedent is needed. The Trust claims that trust law has not changed since the 12th Century, and that trust law should be immune to the changes that led to the Court's decision in *Wayfair*. There are at least two problems with the Trust's logic.

First, the Court's due-process jurisprudence has evolved dramatically since this Court last considered the states' power to tax trusts based on trust beneficiaries' in-state residency.[6] The petition chronicles the development of the law in this area, and how the Court's only guidance on this issue dates back to the era of *Pennoyer v. Neff*, 95 U.S. 714 (1878). *See* Pet. 15–18. The Trust conspicuously avoids discussing whether that *Pennoyer*-era guidance is still good law.

---

[6] The Trust is mistaken when it alleges that the petition contains an error on the age of this Court's precedents. Opp. 27. The petition accurately states that it has been ninety years since the Court addressed (in *Safe Deposit*) whether states can tax trusts based on in-state beneficiaries; it has been seventy years since the Court addressed (in *Greenough*) due-process limits on trust taxation more generally. *See* Pet. i, 15–18.

Second, the profound technological changes since the *Pennoyer* era—most notably, the internet, e-mail, and online banking—have made it much easier for settlors and beneficiaries to avoid state taxes by placing investments in trusts administered in other states.[7] Unlike in the 1920s, when the Court decided *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929), trust assets today move across state lines with a single click of a mouse. Thus, the Trust is mistaken when it says there is no reason to revisit outdated precedent in this area.

For these reasons, this case is an appropriate and timely vehicle to address the question presented.

III. The Trust's arguments on the merits are unavailing.

The Trust ends its brief with several pages of arguments on the merits. These arguments fall short in at least two ways.

First, the Trust's merits discussion highlights the failings of a rigid, presence-based analysis of due process. That analysis, which the court below adopted, theorizes that a trust beneficiary is entirely

---

7 The Trust's brief also reveals this case as an example of how trusts are exploiting a judicially created tax shelter. The Trust engaged a trustee in Connecticut, conducted its business in New York, and existed solely for the benefit of a resident of North Carolina. Yet if the Trust succeeds in this case, none of those states (or any other) will have taxed the full extent of the Trust's income during the tax years at issue.

disconnected from her trust, so her contacts with the taxing state simply do not matter for due-process purposes.

As the petition points out, that formalistic theory conflicts with this Court's modern due-process jurisprudence. That theory also overlooks the fundamental nature of a trust—a legal fiction that exists solely for the benefit of the beneficiary, who holds "an actual property interest in the subject-matter of the trust." *Commonwealth v. Stewart*, 12 A.2d 444, 446–47 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941); *see also* George Gleason Bogert, *The Law of Trusts and Trustees* § 114 (3d ed. 2008); Pet. 18–21. The Trust leaves that fundamental point unrebutted.[8]

In any event, the point of the petition is not to decide which side of the split in authority is right; it is to give this Court an opportunity to decide which side is right. For decades now, the question presented has generated widespread litigation. That litigation has

---

[8] The Trust also briefly raises the issue of whether the "income attributed to the State for tax purposes" was "rationally related to values connected with the taxing State." Opp. 30 (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992)). By focusing only on where its income was generated, the Trust treats this case as if it involved corporate-income taxes. *See id.* (citing *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931), a corporate-income-tax case). Taxes on a trust, in contrast, are rationally related to the taxing state's values if the taxes are "apportioned to the value of the equitable interest" held by an in-state beneficiary. *See, e.g.*, *McCulloch*, 290 P.2d at 416 n.5; *Stewart*, 12 A.2d at 446 (same). That test is satisfied here, because North Carolina has taxed the Trust only on income that was earned "for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2 (2017).

intensified recently, culminating in three decisions in the past five years—including a case in which the State of Minnesota now seeks certiorari. *See Fielding*, 916 N.W.2d 323, *petition for cert. filed*, No. 18-664 (Nov. 15, 2018). Without this Court's intervention, the direct split here will only worsen.

Thus, regardless of who is right on the merits, the Court should grant the petition to resolve the split that the petition describes.

*   *   *

In sum, the Trust's brief only confirms that the Department's petition should be granted. The Trust's reliance on factual minutiae to explain away the direct split does not succeed. Its attempt to manufacture a vehicle problem highlights why this case is a clean and timely vehicle to address the question presented. Finally, the Trust's *Pennoyer*-era theory for why it should win on the merits only demonstrates the need for this Court to modernize its trust-taxation jurisprudence.

The Due Process Clause should not have different meanings across nine states, especially when billions of dollars in state-tax revenue hang in the balance. It is time for this Court to resolve this conflict.

CONCLUSION

The petition should be granted.

Respectfully submitted,

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

December 14, 2018