No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

PETITIONER'S REPLY BRIEF

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INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

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

ARGUMENT

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

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

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

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

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

When a state taxes trust income, that tax does not burden a trustee economically. Instead, "only [the beneficiary] is ultimately burdened." *Stone v. White*, 301 U.S. 532, 538 (1937). In *Stone*, the Court recognized that "in the realm of reality it was the beneficiary's money which paid the tax." *Id.* at 535. The Court declined to "shut its eyes to [that] fact." *Ibid.*[1]

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

The facts here underscore this principle of trust law:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- For example, in the state supreme court, the Trust argued that "it is the entity the state seeks to tax—*here the Trust*—that must have the connection with the forum state." Resp't's N.C. S. Ct. Br. 27 (emphasis added).

- Likewise, at the petition stage in this Court, the Trust framed this case as one in which "the State sought to tax the . . . income of a trust." Resp't's Cert. Opp. i (Question Presented). It went on to argue that "[t]he Kaestner Trust has no connection to North Carolina." *Id.* at 8.

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

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

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

That new argument fails for multiple reasons.

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

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

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

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

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

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

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

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

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

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

* * *

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Trust does not address *Stewart* at all.

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

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

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

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

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

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

1. *Hanson* is inapposite here.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

III. The Trust's remaining arguments fail.

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

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

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

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

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

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

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

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

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

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

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

In addition, a trust's accumulation of income has immediate benefits for the beneficiary. As noted above, trusts can make low-interest-rate loans to beneficiaries, allowing them to enjoy the trust's accumulated income without paying any personal income tax. Tax Profs.' Br. 20–21. That is exactly what happened here. Pet. App. 3a; App. 99–100, 113.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

First, the Trust's "absolute discretion" argument misses the point. What matters for due-process purposes is whether a resident beneficiary is *eligible* to receive distributions at the time of the tax. *See supra* pp. 19–21. When a beneficiary is eligible for distributions, state services to the beneficiary benefit the trust. Pet'r's Br. 33–36. These state services help a trust conserve its income and garner investment returns. *Id.* at 31–32. Here, throughout the tax years at issue, Ms. Kaestner and her children were the only people eligible for distributions from the Trust. *See* App. 46–47 (art. 1.2(a)–(b)).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

CONCLUSION

The state supreme court's decision should be reversed.

Respectfully submitted,

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