No. 18-664

In The
Supreme Court of the United States

CYNTHIA BAUERLY, Commissioner
of the Minnesota Department of Revenue,

Petitioner,

v.

WILLIAM FIELDING, TRUSTEE, et al.,

Respondents.

On Petition For Writ Of Certiorari
To The Minnesota Supreme Court

BRIEF IN OPPOSITION TO CERTIORARI

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QUESTION PRESENTED

Minnesota defines a "resident trust" to include an inter vivos trust whose grantor was domiciled in Minnesota at the time the trust became irrevocable. The four trusts that are Respondents in this case became irrevocable in 2011, when the grantor was domiciled in Minnesota. For the 2014 tax year at issue, Minnesota taxed the Trusts as residents on their worldwide income, even though the grantor had no power over or interest in the Trusts. Because the residency classification is permanent (the trusts cannot change residency), Minnesota will continue to tax the trusts as residents for as long as they exist.

The question presented is whether the Minnesota Supreme Court correctly held that this violates the Due Process Clause as applied to the four trusts.

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INTRODUCTION

The Due Process Clause allows a state to tax a nonresident on income having a source within the state. *Shaffer v. Carter*, 252 U.S. 37 (1920). By contrast, a state may tax its own residents on income they earn from anywhere in the world. *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937); *Lawrence v. State Tax Comm'n*, 286 U.S. 276 (1932).

The Respondents are four inter vivos trusts (the "Trusts") whose grantor ("Grantor MacDonald") was a Minnesota resident in 2011, when the trusts became irrevocable. The tax year is 2014, during which Grantor MacDonald had no interest in or power over the Trusts. Nonetheless, Minnesota taxed the Trusts as residents (on their worldwide income) because Minnesota law defined a trust as a resident if the grantor of the trust was domiciled in Minnesota at the time the trust became irrevocable (a "grantor-domicile rule"). Minn. Stat. § 290.01, subd. 7b(a) (2014). The Minnesota Supreme Court held that Minnesota's grantor-domicile rule, as applied to the Trusts which had only "extremely tenuous" contacts with Minnesota, App. 18, was unconstitutional under the Due Process Clause. The court stated: "The relevant connections are Minnesota's connection to the trustee, not the connection to the grantor who established the trust years earlier." App. 13.

This Court recently granted North Carolina's petition for certiorari in *Kaestner 1992 Family Trust v. North Carolina Department of Revenue*, 814 S.E.2d 43

(N.C. 2018), *cert. granted*, No. 18-457, 2019 WL 166876 (U.S. Jan. 11, 2019). Although *Kaestner* involves the income taxation of a trust as a state resident, the issue in *Kaestner* is quite different. North Carolina law taxes a trust as a resident if a beneficiary resides in the state—it has a "beneficiary-domicile rule." Minnesota employs a grantor-domicile rule.[1]

Although both states rely on the connections of a third party rather than the connections of the trust itself, there are much more serious due process infirmities presented by Minnesota's grantor-domicile rule than by North Carolina's beneficiary-domicile rule. One difference is that while North Carolina relies on the beneficiary's presence *during the taxable year* to establish residency, Minnesota relies on a single *historical connection*: to wit, Grantor MacDonald's connection to the trust ended in 2011, but the tax year in question is 2014, when he had no interest in or power over the Trusts.

A second distinction is that, under North Carolina's statute, if a beneficiary relocated out of North Carolina, the trust would no longer be a resident.

[1] The Minnesota Commissioner asserts incorrectly that 23 states have grantor-domicile rules. Pet. 8, n. 2. She includes states whose statutes do not implicate grantor domicile, such as Iowa. Iowa law says that the residency determination is made based on "relevant facts," but the domicile of the grantor "is not a controlling factor . . . unless the person is also a trustee." Iowa Admin. Code § 701-89.3 (422) (2018). In actuality, there are 12 states that "tax an inter vivos trust solely because the [grantor] resided in the state." Nenno, Tax Management Portfolio, State Income Taxation of Trusts, No. 869, at II.D.

Under Minnesota's statute, the grantor's residence when the trust became irrevocable results in a permanent classification of the trust as a resident. Minnesota makes residency an immutable characteristic. Because Grantor MacDonald was a Minnesota resident in 2011, the Trusts would be Minnesota residents for decades. Once a resident, always a resident.

Yet another difference between *Kaestner* and this case is that although there arguably is a split in state court decisions addressing beneficiary-domicile rules,[2] there is no split in state court decisions addressing grantor-domicile rules as applied to inter vivos trusts. The Minnesota Supreme Court's decision is consistent with the unanimous view of every other state court (four of them) to consider the question. Furthermore, contrary to Petitioner's claim, neither the Minnesota Supreme Court nor any of the other state courts has said that the due process problem was double taxation. Pet. 10-12. As New York's highest court, in holding a grantor-domicile statute unconstitutional, said: "The lack of power of New York State to tax in this instance stems not from the possibility of double taxation but from the inability of a State to levy taxes beyond its border." *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964).

Petitioner tries to fabricate a split by citing very different cases involving *testamentary* trusts—that is,

[2] North Carolina's *Kaestner* decision may split with *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), discussed below, although there are factual differences.

trusts created through the probate of the grantor's will. Some states (including Minnesota) classify testamentary trusts as residents if the grantor's will is probated in the state. Petitioner cites cases holding that *this* connection satisfies due process to establish a purported split. However, the cases are distinguishable because testamentary trusts owe their existence and supervision to state probate courts. There is a nexus with the state that simply does not exist for an inter vivos trust, and the cases recognize the distinction. *See, e.g.*, *Linn v. Dep't of Rev.*, 2 N.E.3d 1203, 1210 (Ill. App. 2013) ("[A]n irrevocable inter vivos trust does not owe its existence to the laws and courts of the state of the grantor in the same way a testamentary trust does and thus does not have the same permanent tie."); *and D. C. v. Chase Manhattan Bank*, 689 A.2d 539, 547, n. 11 (D.C. App. 1997) (An inter vivos trust "does not owe its existence to the laws and courts of the District in the same way that the testamentary trust . . . does, and thus it does not have the same permanent tie to" the taxing state.).

Every court to consider grantor-domicile rules *as applied to inter vivos trusts* has agreed that due process does not allow states to tax a trust as a resident based on the grantor's historical domicile.

Petitioner addresses the minimum connection requirement (called nexus), but she says nothing about the *additional* due process requirement that there be "a 'rational relationship' between the income the state seeks to tax and the protections and benefits conferred by the state." App. 11.[3] A minimum connection (nexus) permits a state to tax a nonresident on income having a *source* within the state, but taxing a person on *unapportioned worldwide* income requires more than a mere minimum connection.[4]

This is yet another distinction between *Kaestner* and the instant case. The North Carolina Supreme Court addressed only the minimum connection requirement. 814 S.E.2d at 48, and at 52, n. 1 (recognizing the rationally-related requirement, but stating the court was concerned only with the minimum-connection requirement). The Minnesota Supreme Court addressed both requirements.

Regarding the minimum-connection test, the court held that Grantor MacDonald's 2011 domicile in Minnesota did not create the necessary minimum connection for the 2014 tax year. App. 12-13. That would have been sufficient for the Trusts to prevail, but the court went on to consider whether the income being taxed (100 percent of worldwide income) had a rational

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[3] The two-part due process test for an income tax was set forth in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978). *See also Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992); *and Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 436-437 (1980).

[4] For example, in *Shaffer v. Carter*, 252 U.S. 37, 57 (1920), the taxpayer was an Illinois resident who conducted an extensive oil and gas business in Oklahoma. He had much more than a minimum connection, but he was not taxed by Oklahoma on his worldwide income. This Court upheld Oklahoma's taxation of his income from Oklahoma sources only.

relationship to the protections and benefits provided by Minnesota. App. 12-19.

The court's analysis of the rational-relationship test was fact-specific. After reviewing the facts, the court determined that the Trusts' contacts with Minnesota were "extremely tenuous" during the tax year. App. 18. It said: "[T]he Trusts had almost no contact with the State during the tax year at issue." *Id*. The court held that "[a]ttributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the Trusts from Minnesota during the tax year at issue." *Id*. at 21.

This alternative basis for decision was clearly correct; it is also fact-bound and is not deserving of review by this Court.

STATEMENT OF THE CASE

The respondent is William Fielding (the "Trustee"), a Texas resident, who is the trustee of four Trusts created in 2009 by a Minnesota resident, Grantor MacDonald.

Grantor MacDonald established the Trusts in 2009 by entering into trust agreements with Edmund MacDonald, as trustee, who was a California resident. Through 2011, the Trusts were grantor trusts whose income was taxed to Grantor MacDonald. Minn. Stat. § 290.01, subd. 7b(a) (2014). On December 31, 2011, Grantor MacDonald signed a release of the power to substitute assets. As a result, the Trusts ceased being grantor trusts and Trust income became taxable to the Trusts.[5] Grantor MacDonald retained no interest in or powers over the Trusts.

The Trusts had only one trustee at any given time, who was the same trustee for each of the Trusts. At no time was any trustee domiciled in Minnesota. During the 2014 tax year at issue, Katherine Boone was the sole trustee until July 24, 2014, and then William Fielding became the sole trustee (a position he still holds). Ms. Boone was a Colorado resident; Mr. Fielding was (and is) a Texas resident. Neither Ms. Boone nor Mr. Fielding performed any duties as trustee in Minnesota.

The primary beneficiary of each separate Trust is a child of Grantor MacDonald: Maria, Catherine, Laura and Vandever. The only child who was a resident of Minnesota was Vandever. He was attending college in New York in 2014, but filed a Minnesota resident income tax return.

[5] Pursuant to Article 2.1 of the trust agreements, the Trusts were always irrevocable under nontax law, as Grantor MacDonald's only retained power was to replace trust assets with assets of equal value, which he relinquished in 2011. The Commissioner characterizes that power as "control," Pet. 18, but in fact it was a very limited power, albeit a power sufficient to make the Trusts grantor trusts for income tax purposes. Under the Minnesota residency statute, they were deemed "irrevocable" when they ceased to be grantor trusts. Minn. Stat. § 290.01, subd. 7b(a).

The beneficiaries have no right to any distributions from the Trusts at any time. Distributions are entirely within the discretion of the Trustee. Each beneficiary is, therefore, a *discretionary beneficiary* of his or her own Trust.

Each child is a *contingent beneficiary* of the Trusts for his siblings. Vandever, for example, is a contingent beneficiary of the Trusts for his sisters. If a sister predeceased him without leaving surviving issue, a portion of the assets in her trust would be paid to Vandever's Trust, and another portion to the Trusts of the other surviving siblings or their issue.

Prior to August 1, 2014, each of the Trusts owned nonvoting common stock in Faribault Foods, Inc. ("FFI"), an S corporation engaged in the manufacture and sale of food products. FFI was based in Minnesota (where it was incorporated) but had activities in other states. Under Minnesota's tax apportionment statutes, the following percentages of FFI's net income were attributed to Minnesota: 11.228 percent for its fiscal year ended March 31, 2014; and 7.499 percent for its short year ended July 31, 2014. On their Minnesota income tax returns for 2014, the Trusts reported their pro rata share of FFI's income apportioned to Minnesota.[6]

[6] An S corporation's income passes through to its shareholders under Minnesota law, as under federal law. Minn. Stat. § 290.9726. Because all shareholders must elect to be taxed individually, in lieu of the corporation being taxed, the Trusts conceded that Minnesota could tax their share of FFI income. However, capital gain realized by a nonresident from selling S corporation stock has not been

On August 1, 2014, each of the shareholders of FFI sold all of his, her or its stock to La Costeña USA, Inc. At the time of the sale, each Trust owned nonvoting common stock representing 4.226 percent of all outstanding shares. Mr. Fielding, as trustee and while in Texas, investigated the proposed terms of the sale and exercised his discretion to sell the stock. He then invested the proceeds with an investment advisor located in San Francisco, California. Through the California-managed investment accounts, the Trusts owned diversified investment funds in 2014, from which they received interest and dividends.

Because Minnesota law defined an irrevocable inter vivos trust to be a resident if the grantor of the trust was domiciled in Minnesota at the time the trust became irrevocable, Minn. Stat. § 290.01, subd. 7b(a), and because Grantor MacDonald was domiciled in Minnesota when the trusts became irrevocable in 2011, the Trustee filed the Trusts' 2014 Minnesota income tax returns as resident trust returns under protest, reporting their worldwide income as taxable.[7] The Trusts then filed refund claims reporting only their Minnesota-source income as taxable.[8]

taxable by Minnesota since 1994. 1994 Minn. Laws ch. 416, art. 2, sec. 4.

[7] The Trustee also filed state income tax returns in Arizona, California, Colorado, and Illinois.

[8] The Minnesota-source income for each Trust consisted of its pro rata share (4.226 percent) of the pass-through income of FFI, as apportioned to Minnesota.

After the claims were denied, the Trusts appealed to the Minnesota Tax Court, which held that Minnesota's definition of "resident trust" violated the Due Process Clause as applied to the Trusts:

> [the statute] reaches back through time to a discrete historical moment [when the trust became irrevocable], and purports to rely on state protections extended (to the grantor) at that moment. But . . . due process does not permit this resort to protections provided exclusively in previous tax years. . . . In addition, because the domicile of the grantor at the moment an inter vivos trust became irrevocable is a matter of historical fact, it is—as to the trust—an immutable characteristic. Consequently, residency under this factor will be perpetual, and the due process problem associated with reaching back through time will worsen with each passing year.
>
> Second, the grantor-domicile method of asserting taxing jurisdiction over a trust reaches across persons. Rather than relying on connections with the trust itself, it relies instead on connections with the trust's grantor. . . . [A] connection with the grantor at the time the trust became irrevocable does not entail any connection with the trust at that same moment.

App. 77-78.

The Minnesota Supreme Court affirmed. It noted that, for tax purposes, a trust is a legal entity separate from its grantor. Therefore, Grantor MacDonald's

Minnesota connections were not "relevant to the relationship between the Trusts' income that Minnesota seeks to tax and the protection and benefits Minnesota provided to the Trusts' activities that generated the income." App. 13. The court also rejected the Commissioner's position because the statute "looked back, several years in some cases, to find contacts by persons other than the Trust and the trustees." App. 14, n. 6.

The court next considered whether the contacts between the Trusts and Minnesota meant that there was a rational relationship between the Minnesota benefits received by the Trusts and the taxation of 100 percent of the Trusts' worldwide income. Petitioner claimed there was a rational relationship and pointed to the following contacts: the use of a Minnesota law firm to draft the trust agreements and to litigate the tax case; the presence of the original trust agreement in a Minnesota lawyer's office for part of 2014; the ownership of a minority interest in a Minnesota corporation (FFI); a choice of law provision in the trust agreement referring to Minnesota law; and the Minnesota domicile of one beneficiary (Vandever). The court determined that the contacts with Minnesota were "extremely tenuous," App. 18, and held that "[a]ttributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the Trusts from Minnesota during the tax year at issue." *Id*. at 21.

REASONS FOR DENYING THE PETITION

I. The Decision Below Is in Accord With This Court's Due-Process Decisions.

This Court has explained that the Due Process Clause places two restrictions on a state's power to tax income. First, a state may not tax income unless it has some minimum connection with the taxpayer and its income-generating activity. Second, even where a minimum connection exists, the State may tax only so much of the income as is rationally related to "values connected with the taxing State." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978).

If a tax fails either of these standards, it violates the Due Process Clause. Here, the Minnesota Supreme Court held that taxing the Trusts as residents violated both standards.

A. The Trusts Had No Minimum Contacts with Minnesota.

Due process does not allow a state to tax a person *at all* unless the person has a minimum connection (nexus) with the state. This Court has held that state tax nexus is closely related to the due-process standard for specific personal jurisdiction. *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992). *Quill* observed: "[I]f a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's in personam jurisdiction even if it has no physical presence in the State." *Id*. at 307-308. The same purposeful availment also creates a nexus with the state for tax purposes. *Id*. at 308.

In the personal-jurisdiction context, this Court has made clear that a trust's contacts with a state cannot be conflated with the contacts of the trust's grantor or beneficiaries. In *Hanson v. Denckla*, 357 U.S. 235 (1958), this Court held that Florida lacked personal jurisdiction to determine the validity of a trust, even though the trust's grantor lived there until her death, and most of its beneficiaries also lived there. Rather, personal jurisdiction over the trust arose in Delaware, where the trustee was located. More recently, in *Walden v. Fiore*, 134 S. Ct. 1115 (2013), this Court emphasized that personal jurisdiction must arise out of the defendant's own contacts and not those of a third party. Describing *Hanson*, the Court stated that "[w]e have . . . rejected a plaintiff's argument that a Florida court could exercise personal jurisdiction over a trustee in Delaware based solely on the contacts of the trust's settlor, who was domiciled in Florida and had executed powers of appointment there." *Id*. at 1121.

The Minnesota Supreme Court applied a similar analysis in holding that the relevant connection was with the Trustee. The court noted that a "trust is its own legal entity, with a legal existence that is separate from the grantor or the beneficiary." App. 14. It held:

> [T]he grantor's connections to Minnesota—the Minnesota residency of Reid MacDonald in 2009, when the Trusts were established; in 2011, when the Trusts were made irrevocable; and in 2014, when the Trusts sold the FFI

> stock—are not relevant. . . . The relevant connections are Minnesota's connection to the trustee, not the connection to the grantor who established the trust years earlier.

App. 13.

Minnesota law contains a grantor-domicile rule, not a beneficiary-domicile rule. Nonetheless, the court addressed the Minnesota residency of one beneficiary, Vandever MacDonald. Because a trust is an entity "with a legal existence that is separate from . . . the beneficiary," "the Minnesota residency of beneficiary Vandever MacDonald does not establish the necessary minimum connection to justify taxing the Trusts' income." *Id*. 12-14. The court's holding is entirely consistent with *Hanson*.[9]

Although *Kaestner* presents the question of whether North Carolina's beneficiary-domicile rule is constitutional, the Minnesota Supreme Court's statement regarding Vandever's residency should be regarded as dictum because beneficiary residency is irrelevant under the applicable Minnesota statute.

But even if it is not dictum, Vandever's beneficial interest in the Trusts is much more attenuated than the interest of the *Kaestner* beneficiary. *Kaestner* involved the 2008 year; although distributions were within the discretion of the trustee in 2008, the beneficiary

[9] It is also consistent with *Greenough v. Tax Assessors of Newport*, 331 U.S. 486, 495-496 (1947) ("The citizenship of the trustee and not the seat of the trust or the residence of the beneficiary is the controlling factor.").

was entitled to a complete distribution of trust assets in June 2009, when she turned 40. 814 S.E. 2d at 45. By contrast, regarding the Trust for which Vandever was the primary discretionary beneficiary (his own trust), Vandever was not entitled to any distributions at any time. Distributions were *always* discretionary with the Trustee. Although his Trust had Minnesota taxable net income of $2,661,597 in 2014, the Trustee distributed just $7,200 to Vandever. (Vandever paid Minnesota income tax on that distribution.)

Vandever had a discretionary interest in his own Trust; his interest in the Trusts for his sisters (who were not Minnesota residents) was contingent. Vandever's Trust might receive distributions from a sister's Trust only if a sister pre-deceased him without issue. (Two of his sisters have had issue since this case commenced.) The Minnesota Supreme Court properly dismissed Petitioner's argument that the sisters' Trusts could be taxed because of Vandever's contingent interest. App. 14, n. 6.

B. The 100-Percent Portion of the Income that Minnesota Would Tax Is Not Rationally Related to "Values Connected with the Taxing State."

As an alternative basis for its conclusion that the Trusts could not be taxed as residents consistent with due process, the Minnesota Supreme Court held that the tax was not rationally related to what Minnesota provided in terms of legal protections and services.

When a state seeks to tax 100 percent of a person's worldwide income by treating him as a resident, the required connection to the state must be substantial. Domicile (where a person makes his home) traditionally provides the basis for taxing an individual as a resident because "[e]njoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government." *Lawrence*, 286 U.S. at 278.

Minnesota (like some other states) treats a non-domiciled individual as a resident if the individual has an abode in Minnesota and spends more than one-half the year physically present in the state. Minn. Stat. § 290.01, subd. 7(b) (2014). Again, the connection is substantial—state protections and services are provided for more than half the year.

By contrast, Minnesota's statutory residency definition for irrevocable inter vivos trusts requires no contact at all between the trust and the state. It relies on the state's historical connection to a separate person—the grantor. It permanently brands a trust a resident based on that historical connection, making it impossible for the trust to change its residency.

In a fact-bound analysis, the Minnesota Supreme Court considered other "contacts" asserted by Petitioner for why the rationally-related test was purportedly met: Vandever's residency in Minnesota; the ownership of a minority stock interest in a Minnesota corporation (FFI); a choice of law provision in the trust agreement referring to Minnesota law; the use of a Minnesota law firm (by the grantor) to draft the trust agreements and (by the Trustee) to litigate the tax case; and the presence of the original trust agreement in a Minnesota lawyer's office for part of 2014. App. 18-21. The Minnesota Supreme Court determined that these "contacts" were "extremely tenuous," and held that "[a]ttributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the Trusts from Minnesota during the tax year at issue." *Id*. at 21.

Vandever's beneficial interest has been addressed above. He had only a discretionary interest in his own Trust because he had no right to any of the Trust's income, and only a contingent discretionary interest in his sisters' Trusts.

The dissenting opinion in the Minnesota Supreme Court stated that the Trusts' ownership of stock in a Minnesota corporation (FFI) provided a rational relationship, but that conflates the corporation (which received state benefits) with the Trusts (which did not). App. 25. The fact that the capital gain from selling FFI stock was not taxed troubled the dissent, but that was the result of a deliberate legislative choice. Minnesota formerly taxed an apportioned share of a nonresident's capital gain from selling stock in an S Corporation, but it repealed that tax in 1994. 1994 Minn. Laws ch. 416, art. 2, sec. 4.

We know of no case holding that owning stock in an in-state corporation means that the shareholder can be taxed as a state resident. By analogy, owning such stock does not give a state personal jurisdiction. *Shaffer v. Heitner*, 433 U.S. 186, 211 (1977) (ownership of stock in a Delaware corporation did not "provide contacts with Delaware sufficient to support the jurisdiction of that State's courts over" the shareholder).

The Minnesota choice of law provision was simply an agreement as to which state's laws governed the trust agreements. The provision did not mean that trust disputes would be litigated in Minnesota courts, as the Minnesota Supreme Court recognized. App. 18. *Cf. Shaffer*, 433 U.S. at 215 ("[W]e have rejected the argument that if a State's law can properly be applied to a dispute, its courts necessarily have jurisdiction over the parties to that dispute."). Indeed, under *Hanson*, Minnesota courts would not have jurisdiction given that the Trustee was a Texas resident who performed all trust duties outside Minnesota.

The Minnesota Supreme Court's holding that there was no rational relationship between the income Minnesota sought to tax (worldwide income) and the protections and benefits provided by Minnesota meant that even if the Trusts had nexus with Minnesota, the state could not tax all of their worldwide income, which included income earned on investments managed in California that had no conceivable connection to Minnesota.

Kaestner did not reach this issue. 814 S.E.2d at 48. If it had, most likely the court would have held that the rational-relationship test was not met. However, in *Kaestner*, ownership of the trust assets was on the cusp of vesting in the discretionary beneficiary, which distinguishes the case from the instant case, where none of the beneficiaries would ever vest under the trust agreements (unless the Trustee made a discretionary distribution).

The Minnesota Supreme Court's holding is manifestly correct. It is also based on the specific facts of this case. For these reasons, certiorari should not be granted.

II. Petitioner's Asserted Split Among State Courts Is Illusory.

A. State Courts Have Unanimously Struck Down Grantor-Domicile Rules for Irrevocable Inter Vivos Trusts.

The Minnesota Supreme Court's holding that Minnesota's grantor-domicile rule is invalid as applied under the Due Process Clause is consistent with the holdings of all state courts that have addressed a similar statute where the taxpayer has been, like the Trusts here, an irrevocable inter vivos trust. *See Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964); *Blue v. Dep't of Treasury*, 462 N.W.2d 762 (Mich. Ct. App. 1990); *Linn v. Dept. of Rev.*, 2 N.E.3d 1203 (Ill. App. 2013); *Potter v. Taxation Div.*, 5 N.J. Tax 399 (N.J. Tax 1983).

In *Mercantile-Safe Deposit*, the trust's grantor and beneficiaries lived in New York, but the trustee lived in Maryland and held and managed the trust's assets there. New York law would have treated the trust as a New York resident based on the grantor's domicile at the time the trust became irrevocable, but the New York Court of Appeals held that due process forbids this. The court's rationale was extraterritoriality, not double taxation: "The lack of power of New York State to tax in this instance stems not from the possibility of double taxation but from the inability of a State to levy taxes beyond its border." 203 N.E.2d at 490.

Blue involved a trust with a Michigan grantor but a Florida trustee and beneficiary. Based on the grantor's domicile in 1962, when the trust became irrevocable, a Michigan statute would have treated the trust as residing in Michigan in tax years 1982-1987. The Michigan Supreme Court held that violates due process, because Michigan "provided no present benefits or protections to the subject trust," 462 N.W.2d at 763-764. It noted:

> We analogize the present case to a hypothetical statute authorizing that any person born in Michigan to resident parents is deemed a resident and taxable as such, no matter where they reside or earn their income. We believe this would be clearly outside of the state's power to impose taxes.

Id. at 764-765.

The trustee in *Linn* lived in Texas and the trust had no connection to Illinois for the tax year at issue, but Illinois law would have treated the trust as a resident based on the grantor's historical residence there. The court found that this violated due process because there was not even a "minimum connection" between the trust and Illinois.

In *Potter*, a New Jersey court held that the state's grantor-domicile rule violated the Due Process Clause for an irrevocable inter vivos trust with a New Jersey grantor but an out-of-state trustee. The court said:

> The ability of the State of New Jersey to tax the undistributed income of this inter vivos trust depends on the existence of sufficient contacts and benefits to comply with constitutional due process requirements. The domicile of the settlor at the time of the creation of the irrevocable inter vivos trust is not in itself a sufficient contact to support taxation by New Jersey.

5 N.J. Tax at 404. Contingent beneficiaries resided in New Jersey, but the court said: "The fact that contingent beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New Jersey to tax undistributed trust income where the contingent beneficiaries have no right to the undistributed trust income." *Id*. at 405.

Petitioner claims that these decisions "commonly cite *Safe Deposit and Trust Co. of Baltimore v. Virginia*, 280 U.S. 83 (1929)." She infers from this that the courts must have been concerned about double taxation.[10] They were wrong, she says, because this Court in *Curry v. McCanless*, 307 U.S. 357 (1939), held that more than one state may tax the same property. Pet. 10-11.

Petitioner is incorrect. Five state courts have held that a grantor-domicile rule violates due process for inter vivos trusts. Some of these have cited *Safe Deposit*, but none has rested its decision on concerns about double taxation. When New York's highest court cited *Safe Deposit*, it expressly stated that the due-process concern was not double taxation but "the inability of a State to levy taxes beyond its border." 203 N.E.2d at 490. The Michigan court in *Blue* summarized the holding of *Safe Deposit* as: "A state statute which attempts to tax things wholly beyond the state's jurisdiction or control conflicts with the Fourteenth Amendment." 462 N.W.2d at 763-764. The court did not discuss double taxation. Similarly here, although the Minnesota Supreme Court cited *Safe Deposit*, it said nothing about double taxation. App. 13, 16. The courts in *Linn* and *Potter* did not cite *Safe Deposit* and did not discuss double taxation. None of the five cases is inconsistent with *Curry*.

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[10] *Safe Deposit* involved a trust with a Virginia grantor and beneficiaries, but whose trustee and property were in Maryland. This Court held that the Due Process Clause precluded Virginia from taxing the trust corpus. Although the Court alluded to double taxation, its holding did not rest on that ground, but rather rested on the basis that trustee and the corpus were outside the state's jurisdiction. 280 U.S. at 92.

B. The Cases Cited by Petitioner Do Not Create a Split.

Petitioner's assertion that there is a split of authorities relies heavily on cases involving testamentary trusts. These are readily distinguishable from inter vivos trust cases like this one.

A testamentary trust—one created by the grantor's will—owes its existence to the laws and probate courts of the state where the grantor was domiciled at death. State probate courts also exercise continuing jurisdiction to resolve trust disputes and other matters. Inter vivos trusts, by contrast, are agreements between private persons (the grantor and the trustee). They do not arise from the exercise of a state court's jurisdiction. Courts of the state where the grantor is or was domiciled do not, by reason of that connection, have jurisdiction over trust disputes, as *Hanson* makes clear.

These distinctions were recognized in *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. App. 1997). There a testamentary trust was created when the grantor died in the District, and the estate was probated in a District court. On those facts, the court held that "the District's ties to the trust itself justify both the District's continuing, supervisory jurisdiction over the entire trust . . . and the District's taxation of the entire net income of the trust. . . ." *Id*. at 544. The court distinguished grantor-domicile rules from inter vivos trusts because an inter vivos trust "does not owe its existence to the laws and courts of the

District in the same way that the testamentary trust at issue in the present case does, and thus it does not have the same permanent tie to the District." *Id*. at 547, n. 11.

The two Missouri cases cited by Petitioner (*see* Pet. 14) also involved testamentary trusts. In *In re Swift* the Missouri Supreme Court actually *rejected* the argument "that the administration of Swift's estate by a Missouri probate court, together with Swift's Missouri domicile at death and the creation of the subject trusts by a 'Missouri' will, provide a sufficient nexus to justify the imposition of income tax." 727 S.W.2d 880, 882 (Mo. 1987). And in *Westfall v. Director of Revenue*, the court simply held that Missouri nevertheless can have jurisdiction to tax a testamentary trust if there are Missouri contacts *added to* probate-court administration and the grantor's domicile at death. 812 S.W.2d 513, 515 (Mo. 1991). The Missouri cases do not split with cases holding that a grantor-domicile rule for inter vivos trusts violates due process.

In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), the Connecticut Supreme Court held that the state could treat three testamentary trusts as residents based on the grantor's residence there at death. The court reasoned that:

> The [state's] unquestioned power to resolve disputes over the trust and to order accountings to protect the trust corpus and beneficiaries from potential malfeasance by the trustee reflects the [state's] justifiable, though

> not necessarily exclusive, jurisdiction over the trust itself.

Id. at 800 (quoting *Chase*, 689 A.2d at 544). These considerations do not apply to inter vivos trusts.

Gavin additionally involved one inter vivos trust. Connecticut's statute taxed the trust as a resident if *both* the grantor and a noncontingent beneficiary lived in the state. The Connecticut Supreme Court held that the grantor's historical Connecticut domicile *alone* did not support taxing the trust as a resident:

> [T]he due process test [requires] that the benefits afforded by the state to a domiciliary . . . justifying the taxation of its income, must generally span the time period during which the income was earned, and not solely antedate that time period without any continuing effect.

Id. at 801. On this point, *Gavin* is in accord with the five state courts (including Minnesota's) that have invalidated grantor-domicile rules.

However, *Gavin* went on to hold that the trust could be taxed as a resident because it provided protections and benefits to its *noncontingent* beneficiary. *Id*. at 802. A noncontingent beneficiary was defined as a "beneficiary whose interest is not subject to a condition precedent." *Id*. at 787, n. 6. The beneficiary in *Gavin* (1) was entitled to receive mandatory distributions of all income; and (2) was entitled to receive all assets when she reached the age of 48. *Id*. at 788.

Vandever is only a discretionary beneficiary of his own Trust and a contingent discretionary beneficiary of his sisters' Trusts. He has no right to receive distributions at any time from any of the Trusts. If Connecticut's statute were applicable, he would not qualify as a noncontingent beneficiary, meaning that the Trust would not be taxed as a resident.

Gavin does not split with the instant case because Minnesota law, unlike Connecticut law, contains no beneficiary-domicile rule. In addition, the Trusts do not have a noncontingent beneficiary resident in Minnesota.

Also, *Gavin* (like *Kaestner*) addressed only the minimum-connection test and not the rational-relationship test. 733 A.2d at 791-792; 814 S.E.2d at 48. In this case, the Minnesota Supreme Court did address the rational-relationship test and held that there was no rational relationship justifying a tax on 100 percent of the Trusts' worldwide income. App. 18-21.

Finally, Petitioner discusses *T. Ryan Legg Irrevocable Trust v. Testa*, 75 N.E.3d 184 (Ohio 2016), *cert. denied*, 138 S. Ct. 222 (2017), which involved an entirely different issue. The court there decided that the taxpayer was a *nonresident* trust. *Id*. at 197. It then held that, under certain conditions stipulated in Ohio law, the state could tax a *nonresident* trust on a portion of the gains from selling stock in a corporation that did business in Ohio. That holding does not implicate the grantor-domicile rule at all, let alone conflict with other decisions on that issue.

III. The Question Petitioner Seeks To Present Is Irrelevant Because Petitioner Also Loses Under the Commerce Clause.

A tax is valid under the Commerce Clause only if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

The Commerce Clause substantial-nexus requirement is closely related to the due process minimum-connection requirement. *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2093 (2018). The Trusts did not have substantial nexus because their contacts with Minnesota were "extremely tenuous." App. 18.

The fair apportionment requirement is not satisfied because Minnesota seeks to tax 100 percent of the capital gain from selling FFI stock, even though FFI's apportionment percentage was less than 12 percent. Similarly, Minnesota seeks to tax 100 percent of the investment income from a portfolio managed in California, and that tax would not be fairly related to the services provided by Minnesota to the Trusts—there were no such services.

In addition, to be fairly apportioned, and to not discriminate against interstate commerce, a tax must be internally consistent. The internal consistency test posits the hypothetical that Minnesota and all other states have the identical tax. If that would result in multiple taxation, the test is violated. *Comptroller of*

Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1802-1803 (2015).[11]

Petitioner's position is that the Trusts for Vandever's sisters should be taxed as Minnesota residents because Vandever was a contingent beneficiary of those trusts. App. 14, n. 6. That position clearly violates internal consistency. Each of Grantor MacDonald's children was a contingent beneficiary of the Trusts for all of the other siblings. Two sisters were residents of New York; the third was a resident of California. If those states applied the same rule that Petitioner says should apply here (even though the rule is not in Minnesota Statutes), then each of the four Trusts would be treated as a resident of Minnesota, New York and California, because there would be contingent beneficiaries in all of those states. Those three states could tax all of the income of the four Trusts. The internal consistency violation is obvious, and will only get worse. As Grantor MacDonald's children have their own children, which has already occurred, the grandchildren will be contingent beneficiaries of the Trusts. As they mature and move to other states, those states would be entitled to tax the Trusts as residents under

[11] Actual double taxation is not a requirement of the internal consistency test. However, in this case the Trust for Maria was double taxed (by Minnesota and California) on some of the capital gain. Minnesota did not allow a credit. The Minnesota Commissioner's statement that the Trusts had no double taxation is incorrect. Pet. 13.

Petitioner's theory. The entire income of the Trusts would be taxed many times over.[12]

The Minnesota Supreme Court's decision is correct under the Due Process Clause. It would have reached the same result if it had addressed the Commerce Clause.

IV. The Correct Due-Process Test Need Not Result in Tax Avoidance.

Petitioner misreads the Minnesota Supreme Court's opinion to mean that taxation is restricted to the single jurisdiction where the trustee is domiciled. Pet. 9, n. 3. The court never adopted that as a general rule.

Petitioner envisions a "planning opportunity" for Minnesota residents who intend to sell stock: They can put it in a non-grantor trust for a Minnesota beneficiary with a non-Minnesota trustee who would sell the stock. App. 19. Judicial doctrines such as assignment of income and substance over form can be used to prevent such income shifting. *See, e.g.*, *Comm'r v. Court Holding Co.*, 324 U.S. 331 (1945). There are also statutory solutions.

[12] A credit for taxes paid to other states could alleviate multiple taxation, but Minnesota's credit is not available for taxes imposed by another state on the intangible income of a Minnesota resident. Minn. Stat. § 290.06, subd. 22(d) (2014).

Petitioner's "planning opportunity" is factually similar to what happened in Ohio's *Legg* case. Ohio law foreclosed the income shifting by taxing a nonresident trust on an apportioned share of capital gain from selling S corporation stock. Minnesota could adopt a similar statute, and actually had such a statute before 1994.

California takes another approach. If a trust with a resident beneficiary does not pay California tax, California taxes the resident beneficiary as a transferee of the trust when she receives a distribution of the untaxed income. Cal. Rev. & Tax. Code § 17745.

Contrary to the Petition, fiscal Armageddon is not at hand.[13] Moreover, the Minnesota Legislature has the ability to solve any perceived problem.

[13] Minnesota identified litigation that could have a material adverse effect exceeding $15 million in a bond prospectus dated August 7, 2018. It listed two other tax cases but not this case. *See* https://mn.gov/mmb-stat/debt-management/bonding/official-statements/2018/MNState01a-FIN.pdf.

CONCLUSION

The petition should be denied.

Respectfully submitted,

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