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

PETITIONER'S REPLY BRIEF

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INTRODUCTION

Less than a month ago, this Court granted certiorari in *North Carolina Department of Revenue v. The Kimberly Rice Kaestner 1992 Family Trust*, No. 18-457 ("*Kaestner*"), to resolve whether "the Due Process Clause prohibit[s] states from taxing trusts based on trust beneficiaries' in-state residency." The North Carolina Supreme Court held that it does—that a trust and its beneficiaries are legally separate, and that a beneficiary's contacts with the state are irrelevant in assessing the state's power to tax the trust. This Court accepted the North Carolina Department of Revenue's invitation to review that holding. The Commissioner's petition deserves the same treatment. Further, Respondent's arguments against certiorari are very similar to the trustee's in *Kaestner*. Those arguments are no more persuasive here.

Contrary to Respondent's brief in opposition, there is a direct split among state appellate courts on the question presented in this case. Respondent argues that cases involving testamentary trusts are distinguishable from this case because the trust at issue is *inter vivos*. The Due Process Clause does not impose distinct requirements or standards for testamentary versus *inter vivos* trusts. Furthermore, the decision of the Minnesota Supreme Court conflicts with this Court's existing due process jurisprudence. The trusts at issue in this case had significant connections to Minnesota, and were funded with the stock in a closely held family business that was founded in, and headquartered in Minnesota.

Further, Respondent's contention that the case should not be taken because of an unresolved

Commerce Clause issue in the courts below lacks merit. Grants of certiorari are common and appropriate where the courts below did not address every issue initially presented.

ARGUMENT

I. THERE IS A DIRECT SPLIT IN AUTHORITY AMONG STATE APPELLATE COURTS ON THE QUESTION PRESENTED.

The Minnesota Supreme Court's decision adds to a growing split in authority on the question presented and this Court should grant certiorari to provide state appellate courts with guidance on what the Due Process Clause requires for the taxation of trusts as residents.

A. There is no Meaningful Difference Between *Inter vivos* and Testamentary Trusts for the Purposes of the Due Process Clause.

Respondent contends that a significant distinction exists between cases involving *inter vivos* trusts and cases involving testamentary trusts.[1] Br. in Opp. 23.

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[1] This contention is the reason for the parties' disagreement concerning the number of grantor-domicile statutes. Respondent erroneously contends there are only 12 such statutes because Respondent only counts statutes with an *inter vivos* grantor-domicile rule. The Commissioner correctly counts 23 statutes that impose both a testamentary and an *inter vivos* rule. *See* Pet. 8 at n. 1. Respondent also errs in asserting that there are only 12 states with inter vivos grantor-domicile rules. There are 17. *See* Conn. Gen. Stat. § 12-701 (2018); Del. Code Ann. tit. 30 § 1601 (2018); D.C. Code § 47-1809.01 (2018); 35 Ill. Comp. Stat. Ann.

This is incorrect. Each of the cases that contribute to the split observed by the Commissioner raise the same constitutional issue – can a state tax a trust established by one of its domiciliaries as a resident if the trustee is domiciled elsewhere? *See* Pet. 12-17.

Respondent asserts that *inter vivos* and testamentary cases are distinct because testamentary trusts are established and managed by in-state probate courts. Br. in Opp. 23-24 (citing *D.C. v. Chase Manhattan Bank*, 689 A.2d 539, 547, at n. 11 (D.C. 1997)). Although the court in *Chase* drew a distinction between *inter vivos* trusts and testamentary trusts on that ground, *see id.* at 545, the court also stated "[t]he idea of fundamental fairness, which undergirds our Due Process analysis, therefore *may or may not compel* a different result in an *inter vivos* trust context." *Id.* (Emphasis supplied). Accordingly, the court in *Chase* did not foreclose the possibility that an *inter vivos* trust could have sufficient ties to the District to sustain the residency classification. Instead, the court stated it would need to apply the same due process analysis to determine the constitutional sufficiency of a particular trust's contacts. *Id.* Contrary to Respondent's suggestion, *Chase* does not establish a *per se* distinction between testamentary and *inter vivos* trusts for

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5/1501 (2018); Me. Rev. Stat. Ann. tit. 36, § 5102(4) (2018); Mich. Comp. Laws § 206.18 (2018); Minn. Stat. § 290.01 (2018); Neb. Rev. Stat. Ann. § 77-2714.01 (2018); N.J. Stat. Ann. § 54A:1-2 (2018); N.Y. Tax Law § 605 (2018); Okla. Stat. tit. 68, § 2353 (2018); 72 Pa. Cons. Stat. § 7301 (2018); 1956 R.I. Gen. Laws § 44-30-5 (2018); Vt. Stat. Ann. tit. 32, § 5811; Va. Code Ann. § 58.1-302 (2018); W. Va. Code R. 110-21-7 (West 2018); Wis. Stat. § 71.14(3) (2018).

purposes of determining the sufficiency of minimum contacts.

Additionally, state appellate courts that have considered the issue in a testamentary context are not in agreement with the proposition that being established by an in-state court is a sufficient contact. *See Westfall v. Dir. of Revenue*, 812 S.W. 2d 513 (Mo. 1991) (holding that establishment in-state and additional contacts are constitutionally necessary in a testamentary trust case.). This Court should grant certiorari to decide the level of contact required for a state to tax a trust as a resident. Its ruling need not be confined to the *inter vivos* trust context, because due process requires the same in a testamentary context.

B. State Appellate Courts have Not Universally Rejected Grantor-Domicile Statutes in Cases Involving *Inter vivos* Trusts.

Respondent incorrectly asserts that state appellate courts have unanimously struck down grantor-domicile rules for irrevocable *inter vivos* trusts on Due Process grounds. Br. in Opp. 19. The Connecticut Supreme Court expressly upheld the application of an *inter vivos* grantor-domicile statute in *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 803 (1999). In *Gavin*, the court determined the presence of a non-contingent beneficiary in-state was constitutionally sufficient for taxation of the *inter vivos* trust as a resident. *Id.* Although Respondent attempts to distinguish *Gavin* on the grounds that "Minnesota law, unlike Connecticut law, contains no beneficiary-domicile rule," Br. in Opp. 26, Respondent is mistaken. The Connecticut statute, like the Minnesota statute at issue here, did not

establish a "beneficiary-domicile rule." As with Minnesota law, it specifically set forth a grantor-domicile rule. *Compare* Conn. Gen. Stat. § 12-701(a)(4)(D)(i) (1993) (providing in relevant part that a trust is a resident if it is settled by "a person who was a resident of this state at the time the property was transferred to the trust if the trust was then irrevocable"); with Minn. Stat. § 290.07b (2014) (providing that "[r]esident trust means a trust… which… is an irrevocable trust, the grantor of which was domiciled in this state at the time the trust became irrevocable."). The Connecticut Supreme Court upheld the constitutionality of the statute based on the presence of the beneficiary, but it did not, as Respondent asserts, interpret the statute at issue to provide for a beneficiary-domicile rule. *Gavin*, 733 A.2d, at 803.

Respondent also attempts to distinguish *Gavin* on the grounds it involved a non-contingent beneficiary. Br. in Opp. 25. In reality, the resident beneficiary in *Gavin* was situated in the same fashion as the beneficiary of the Vandever trust in the instant case in 2014. The beneficiary in *Gavin* was 39 years old in 1993, a resident of Connecticut, and was entitled to a distribution of all assets at age 48. *Gavin*, 733 A.2d, at 788 . The beneficiary of the Vandever trust was 21 years old, and a resident of Minnesota during 2014. As such, under the trust agreement, he was entitled to discretionary distributions in 2014 as "necessary or advisable" and, if he has no living issue, will be entitled to the corpus of the trust at age 45. The Vandever trust interest in this case was no more contingent than the beneficial interest in *Gavin*.

II. THE DECISION BELOW CONFLICTS WITH THIS COURT'S DUE PROCESS JURISPRUDENCE.

Respondent's principal argument against certiorari is that the Minnesota Supreme Court's decision was correct. *See* Br. in Opp. 12-19. That would not justify denying certiorari even if true, given the lower court conflict and the importance of the question presented as reflected by the grant of certiorari in *Kaestner*. But it is not true.

A. The Trusts Had Significant Connections With Minnesota.

This Court has ruled consistently that the Due Process Clause requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *S.D. v. Wayfair, Inc.*, 138 S. Ct. 2080, 2093, (2018). This Court has also stated that "income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978)(internal citation omitted). The decision of the Minnesota Supreme Court departed from this Court's existing due process jurisprudence, and warrants certiorari review.

Respondent contends the trusts in this case had "no minimum contacts" with Minnesota. Br. in Opp. 12-13 (citing *Quill Corp. v. N.D.*, 504 U.S. 298, 308 (1998)). To the contrary, Minnesota extended a host of benefits to the trusts in this case, and is entitled to assess the tax at issue consistently with the Due Process Clause. Minnesota is the State of the trusts' creation, with the trusts owing their very existence to its laws. Pet. App. 12. All four trusts were created by Grantor

MacDonald, a Minnesota domiciliary. *Id.* All four original trust documents were drafted by a Minnesota attorney, and elect the application of Minnesota's laws. *Id.* at 35. From the time of the trusts' creation until late 2014, the trust documents were kept in Minnesota. *Id.* at 38. The trusts filed tax returns identifying themselves as Minnesota resident trusts in 2012 and 2013. *Id.* at 4. Vandever MacDonald, one of the four primary beneficiaries, was domiciled in Minnesota in 2014. *Id.* at 12. He is also a contingent beneficiary of each of the other three trusts. *Id.*

Finally, the Trusts' primary asset and source of income during 2014 was stock in Faribault Foods, Inc. ("FFI"), a closely held family business which was incorporated in the State of Minnesota, and has always been headquartered in Minnesota. Pet. App. 57. These facts establish the "minimum contacts" required to permit taxation by Minnesota, as the Trusts have time and again directed their activities towards the State. *See Quill Corp. v. N.D.*, 504 U.S. 298, 308 (1992).

B. Minnesota's Taxation of the Trusts as Residents Was Proportional to the Trusts' Connections to the State.

This Court has long recognized that states have a constitutional ability to levy income taxes on the entire incomes of their domiciliaries in order to equitably share the costs of government. *People of State of New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937). Minnesota law requires that resident trusts pay income taxes on an apportioned share of their annual business income, and on all investment income. *See* Minn. Stat. § 290.17, subds. 1, 2 & 3. Minnesota's system of allowing apportionment for trusts' business income,

and allocating investment income to the state of residency, is designed to be consistent with this Court's Due Process and Commerce Clause jurisprudence. *See Allied-Signal, Inc. v. Dir. Div. of Taxation*, 504 U.S. 768, 785 (1992) (observing that "[s]tate legislatures have relied upon our precedents by enacting tax codes which allocate intangible nonbusiness income to the domiciliary State").

Respondent argues that the State's taxation of its 2014 capital gain income is not rationally related to values connected to the State. Nothing could be further from the truth. The trusts' capital gain stemmed from its sale of stock in FFI. FFI was founded and headquartered in Minnesota, but more importantly, the stock was contributed to the trusts by Grantor MacDonald, who was and still is domiciled in Minnesota. Under this court's long standing precedent in *Graves*, the State had a right to tax all of MacDonald's income. It follows logically that the State can tax the entire capital gain stemming from a sale of stock that he contributed to a trust while domiciled in Minnesota. As the dissenting justices of the Minnesota Supreme Court wrote:

> When a Minnesota grantor knowingly chooses to create a Minnesota resident trust and the trust itself incorporates Minnesota law, why would it be unconstitutional for Minnesota to tax that trust? Put another way: how can it violate due process for a state to tax its residents (in this case, the Trusts) as residents? Other courts have provided a clear answer to this question—it cannot.

Fielding v. Comm'r of Revenue, 916 N.W.2d 323, 335 (Minn. 2018)(Lillehaug, J., dissenting). The dissent also observed that the close ties of FFI itself to Minnesota, and the fact that a beneficiary remained domiciled in Minnesota in 2014, strongly contributed to the rationality of the relationship between the tax and the services received in exchange. *Id.* at 336.

III. THIS CASE IS AN EXCELLENT VEHICLE FOR RESOLUTION OF THE QUESTION PRESENTED.

Respondent contends the Court should not grant certiorari because Respondent would have prevailed in the courts below pursuant to the Dormant Commerce Clause, even if it had not prevailed on Due Process grounds. There is no reason this Court cannot grant certiorari, address the question presented, and remand the case for determination of the Commerce Clause issue, if necessary. In fact, this has been the Court's common practice with cases presenting unresolved secondary issues. *See e.g.*, *S.D. 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 Republican Party*, 552 U.S. 442, 458 n.11 (2008). The Commerce Clause does not present a reason to deny certiorari review.

Moreover, although Respondent presumes it would prevail on Commerce Clause grounds, the Commissioner disagrees.[2] In general, taxes are constitutional under the Dormant Commerce Clause if

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[2] In fact, the only two justices that considered the Commerce Clause issue in the Minnesota Supreme Court would have entered decision in the Commissioner's favor. Pet. App., at 28-29.

they satisfy the standard enunciated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Under *Complete Auto Transit*, a tax is constitutional if: 1) the taxpayer is sufficiently connected to the taxing jurisdiction; 2) the tax is related to a benefit conferred by the jurisdiction; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly apportioned. *Id.* As explained *supra*, at II.A. and B., the taxation at issue here is of four trusts with significant connections to Minnesota. The statute is also non-discriminatory because it does not tax non-resident trusts on their investment income,[3] and the statute is also fairly apportioned through its credit for taxes paid to other states, which reduces the tax paid to Minnesota proportionally by amounts paid elsewhere. *See* Minn. Stat. § 290.06, subd. 22.

IV. THE COURT SHOULD COMBINE THIS CASE WITH *KAESTNER* OR HOLD THE CASE IN CONFERENCE PENDING THE OUTCOME OF *KAESTNER*.

Anticipating the Commissioner's request to combine this case with *North Carolina Department of Revenue v. Kaestner*, Docket No. 18-457, Respondent argues that this case is distinguishable from *Kaestner*, and certiorari is not warranted. Br. in Opp. 1-2. While the two cases do have differences, the similarities are more important. *Kaestner* involves a beneficiary-domicile statute, which taxes trusts if a beneficiary of the trust is a resident of North Carolina. N.C.G.S. § 105-160.2.

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[3] *See Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 1803 (2015) (explaining a tax is non-discriminatory for Commerce Clause purposes if it would not result in multiple taxation, if hypothetically enacted in the other states)

North Carolina counts itself among six states with beneficiary-domicile statutes. North Carolina Department of Revenue Reply Brief, at 1. This case involves a grantor-domicile statute, pursuant to which, Minnesota taxes trusts based on the location of the grantor. Minn. Stat. § 290.01, subd. 7b. As explained *supra*, at I.A., Minnesota is one of 23 states that employs a grantor-domicile statute.

Additionally, the cases share an important factual commonality – the presence of an in-state beneficiary. In the case of both the *Kaestner* trust and the Vandever MacDonald trust in this case, the primary beneficiary was located in the taxing state during the tax year in question. In the *Kaestner* case, this is the only contact that the state relies on to as necessary for resident taxation. North Carolina Department of Revenue Reply Brief, at 6. Accordingly, if the Court rules in favor of the North Carolina Department of Revenue, it follows *a fortiori* that the Minnesota Supreme Court's judgment must be reversed.

The Court can resolve Due Process questions arising from trust taxation in a majority of states by deciding both cases. Because of the similarities between this case and *Kaestner* and the potential to resolve important constitutional issues common to both cases, the Commissioner requests the Court consider combining these cases for argument pursuant to United States Supreme Court Rule 27.3.[4] In the alternative,

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[4] The Petitioner submitted a letter to the clerk accompanying this brief that also requests that the Court consider combination pursuant to Rule 27.3.

the Commissioner asks that the case be held in abeyance pending the outcome of *Kaestner*.

CONCLUSION

For the foregoing reasons, certiorari should be granted. In the alternative, the Commissioner requests the case be held in abeyance pending the outcome of *North Carolina Department of Revenue v. Kaestner*, Docket No. 18-457.

Respectfully Submitted,

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