No. _______

In the

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

More than $120 billion of our nation's income flows through trusts. That income is a vital source of tax revenue for the states. Eleven states, including North Carolina, tax trust income when a trust's beneficiaries are state residents.

For the last ninety years, however, this Court has been silent on whether these taxes comport with due process. The Court's last words on the subject come from the *Pennoyer* era of due-process analysis. *Pennoyer v. Neff*, 95 U.S. 714 (1878). As a result, lower courts and state taxing authorities have been searching in vain for modern guidance.

There is now a direct split spanning nine states. Four state courts have held that the Due Process Clause allows states to tax trusts based on trust beneficiaries' in-state residency. Five state courts, including two state supreme courts this year, have concluded that the Due Process Clause forbids these taxes.

The Due Process Clause should not have different meanings in different states—particularly when billions of dollars of state-tax revenue hang in the balance. The question presented to this Court is:

Does the Due Process Clause prohibit states from taxing trusts based on trust beneficiaries' in-state residency?

PARTIES

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The opinion of the Court of Appeals of North Carolina (App. 27a) is reported at 789 S.E.2d 645 (N.C. Ct. App. 2016).

The state trial court's decision (App. 41a) is published at 12 CVS 8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015).

JURISDICTION

Petitioner, the North Carolina Department of Revenue, respectfully seeks a writ of certiorari to review a judgment of the Supreme Court of North Carolina pursuant to 28 U.S.C. § 1257(a). The Supreme Court of North Carolina issued its opinion on June 8, 2018.

On August 24, 2018, Chief Justice Roberts extended the time to file this petition until October 9, 2018. *North Carolina Dep't of Revenue v. Kimberly Rice Kaestner Family Trust*, No. 18A210 (U.S. Aug. 24, 2018).

CONSTITUTIONAL PROVISIONS

The Due Process Clause of the Fourteenth Amendment provides that "[n]o state shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1.

INTRODUCTION

This case asks whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency—a question on which nine state courts have split.

Because of the Tax Injunction Act, this federal constitutional question is usually litigated in state courts.[1] State courts are divided in their answers to this question, however, because they lack modern guidance from this Court.

Many decades have passed since this Court has addressed the due-process limits of trust taxation. Although the Court has recently considered a number of due-process cases that address states' jurisdiction to adjudicate, those cases do not offer clear guidance on the due-process limits on trust taxation. State courts have struggled to fill this jurisprudential void.

Part of that struggle stems from the unique nature of trusts—entities that frustrate conventional due-process tests. Unlike an individual, a trust is a legal abstraction: a fiction created to represent the tripartite relationship among a settlor, a trustee, and a beneficiary. George Gleason Bogert, *The Law of Trusts and Trustees* § 1 (3d ed. 2008). For this reason, a trust's physical location is debatable.

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[1] The Tax Injunction Act, 28 U.S.C. § 1341 (2012), provides that federal courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

Because of these unusual features of trusts, courts that have applied rigid, formalistic rules to trusts have reached unjust conclusions.

In the decision below, for example, a majority of the North Carolina Supreme Court concluded that a trust and its beneficiaries are legally separate—in other words, that beneficiaries are outsiders to a trust. On that basis, the majority expressly disregarded the trust beneficiaries' in-state residency and other contacts with North Carolina. That analysis led the majority to conclude that the trust at issue lacked a constitutionally sufficient connection with the state. Thus, the majority held that the Due Process Clause barred North Carolina from taxing undistributed income that the trust earned and held for the benefit of the beneficiaries.

With that decision, North Carolina joined the ranks of eight other states that have reached conflicting decisions on the question presented here. Five states have concluded that the Due Process Clause forbids states from taxing trusts based on trust beneficiaries' in-state residency. Four states have concluded the opposite.

Neither side of the split involves uniform reasoning. Some state courts have followed this Court's trust-taxation precedents that predate *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). Other state courts have looked to this Court's modern due-process decisions—for example, cases involving jurisdictional challenges by tort defendants—but have struggled to apply those precedents in the unique context of trust taxation. Moreover, the courts on both sides of the split have disagreed internally, with seven jurists dissenting from the opinions.

This split has serious consequences for state-tax revenues and, more broadly, for federalism principles.

Financially, the states that have barred taxation face sharp cuts to their tax revenues. In fact, these states are exposed to hundreds of millions of dollars of potential claims for tax refunds. In North Carolina, for example, trustees are already pursuing refunds in the wake of the decision below.

In addition, the five state courts that have barred these taxes have undermined important federalism principles. By grounding their decisions in the federal Due Process Clause, those courts have not only forbidden a common form of taxation within their own borders, but have also called it into question in other states.

Because these decisions are based on the federal Due Process Clause, no single state can resolve the confusion. The direct split, and the problems associated with it, will only worsen without this Court's intervention.

STATEMENT

I. How and Why States Tax Trust Income

Generally, if a trust distributes income to a beneficiary, the beneficiary (as opposed to the trust itself) is taxed on that income. 2 Jerome Hellerstein & Walter Hellerstein, *State Taxation* ¶ 20.09, at 20-148 (3d ed. 2003). But when a trust earns income that it holds for its beneficiary, the trust itself is taxed. *Id.*

North Carolina's statute assesses taxes "on the amount of the taxable income of the . . . trust that is for the benefit of a resident of [the] State." N.C. Gen. Stat. § 105-160.2 (2017). Before this lawsuit, that statute (or one of its predecessors) had been in force and unchallenged since 1923.[2]

Taxing a trust's undistributed income based on the trust beneficiaries' in-state residency serves two vital functions.

First, the revenue pays for the many services that states provide to those in-state beneficiaries. These services protect beneficiaries as the undistributed income in their trusts grows. The value of those services is considerable. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2096 (2018) (observing that state taxes "fund the police and fire departments," "maintain the public roads and municipal services," and "support the sound local banking institutions" enjoyed by residents).

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[2] In North Carolina, as in most states, the taxable income of an estate or trust "is the same as taxable income for such an estate or trust under the provisions of the [Internal Revenue] Code," with adjustments similar to the adjustments that apply to individual taxation. N.C. Gen. Stat. § 105-160.2 (2017).

Second, taxing a trust's undistributed income ensures that beneficiaries cannot permanently shelter income earned for their benefit. In the absence of a statute like North Carolina's, a beneficiary could enjoy the protections of a state for most of her life, then avoid taxation by relocating to a non-taxing state before taking a distribution.

For these reasons, eleven states (including North Carolina) tax trusts based on trust beneficiaries' in-state residency.

II. The Kaestner Trust

The Kimberly Rice Kaestner 1992 Family Trust is an irrevocable, *inter vivos* (non-testamentary) trust that was created for the benefit of Kimberly Rice Kaestner and her children. During the relevant period, the Trust contained more than $13 million in assets.

The Trust was created in New York. Its trustee was a resident of Connecticut during the tax years at issue. During those years, Ms. Kaestner and her children were residents of North Carolina.

North Carolina law provides that the state's Department of Revenue may tax trust income "that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2. Thus, the Department assessed taxes on the undistributed income that accumulated in the Trust from 2005 to 2008.

The Trust paid roughly $1.28 million in taxes under protest. Then it filed this lawsuit.

III. The Trust's Constitutional Challenge

The Trust brought this lawsuit as a constitutional challenge in state court. Among its claims, the Trust asserted that North Carolina had violated the Due Process Clause by assessing taxes on undistributed income held by the Trust for the benefit of Ms. Kaestner and her children.[3] The Trust argued that the Trust itself—as opposed to the Trust's beneficiaries—did not have a constitutionally sufficient connection with North Carolina.

The state trial court concluded that North Carolina's assessment of taxes on the Trust violated the Due Process Clause, and therefore ordered a refund.[4] App. 69a. The North Carolina Court of Appeals affirmed. App. 27a.

In a 6-1 decision, the North Carolina Supreme Court affirmed the decision of the court of appeals. App. 1a. The majority held that the in-state residence of the Trust's beneficiaries is not a sufficient connection with North Carolina for due-process purposes.

The majority first characterized a trust as something separate from its beneficiaries—reasoning, in essence, that trust beneficiaries are

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[3] In addition to the Trust's due-process claim, the Trust also brought claims under the Commerce Clause and under the North Carolina Constitution's law-of-the-land clause. That state-constitutional claim is dependent on the Trust's federal due-process claim. *See, e.g.*, *Tully v. City of Wilmington*, 810 S.E.2d 208, 216–17 (N.C. 2018) (explaining that North Carolina's "'law of the land' [clause] is synonymous with 'due process of law,' a phrase appearing in the Federal Constitution and the organic law of many states").

[4] In addition, the trial court held that the Department's assessment of taxes on the Trust violated the Commerce Clause—an issue that neither of the state appellate courts ultimately reached.

third parties to a trust. App. 13a. Next, the majority borrowed principles from this Court's decision in *Walden v. Fiore*, 571 U.S. 277 (2014), which held, in the context of a tort claim, that third parties' contacts with a forum state do not matter for due-process purposes.[5] *Id.* Finally, the court merged these two points and concluded that the Trust's beneficiaries' contacts with North Carolina do not matter in a due-process analysis. On this basis, the court held that North Carolina's trust-tax statute was unconstitutional as applied to the Trust. App. 18a.

Justice Sam J. Ervin, IV, dissented. Criticizing the majority's "formalistic, presence-focused" approach, Justice Ervin concluded that the beneficiaries' in-state residency "has some bearing on the proper performance of the required due process analysis." App. 24a.

Justice Ervin viewed this Court's due-process precedent as requiring a wider-ranging analysis of the Trust's connection with North Carolina—an analysis that would give weight to the in-state residency of the Trust's beneficiaries. *Id.* Applying that analysis, Justice Ervin concluded that the Trust had a constitutionally sufficient connection with North Carolina—a connection that brought the Trust within North Carolina's taxing jurisdiction. *Id.*

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[5] The majority also cited *Hanson v. Denckla*, 357 U.S. 235 (1958), to support this general proposition about third-party contacts. *Hanson* involved a trust, but the issue there was whether a beneficiary's contacts with a state were sufficient to establish adjudicative jurisdiction over a *trustee*, not a trust. *Id.* at 253. Thus, *Hanson* offers no guidance on the question presented here.

REASONS FOR GRANTING THE PETITION

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

A trust is a legal abstraction that evades conventional due-process tests. *See infra* pp. 15–18. The abstract character of trusts, coupled with a lack of contemporary guidance from this Court, has led to confusion among the state courts that have grappled with the question presented. The confusion has produced a direct split that spans nine states.

Four state courts have concluded that the Due Process Clause allows states to tax trusts based on trust beneficiaries' in-state residency:

- In *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), the California Supreme Court found no constitutional prohibition against taxing a trust based on the trust beneficiary's in-state residence. The court began by noting that this Court "ha[d] not yet had occasion to decide the validity of a tax with respect to [a trust's] accumulated income where the trustee is a nonresident and the tax is founded on the residence of the beneficiary." *Id.* at 418. The court went on to hold that a beneficiary's state of residence can tax the trust because "that state renders to the beneficiary . . . protection incident to his eventual enjoyment of such accumulated income." *Id.* at 419.

- In *Westfall v. Director of Revenue*, 812 S.W.2d 513 (Mo. 1991), the Missouri Supreme Court held that Missouri could tax a trust's undistributed income because the trust at issue had several points of contact with the state, one of which was the presence of an in-state beneficiary. *Id.* at 514. Two justices dissented, opining that the tax was unconstitutional because the trustee, the "legal owner of the trust property," was a nonresident. *Id.* at 517 (Blackmar, J., dissenting).

- In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 802 (Conn. 1999), the Connecticut Supreme Court held that states can tax undistributed trust income based on trust beneficiaries' in-state residency. The court emphasized the "protection and benefits" that states provide beneficiaries and found that the beneficiary's in-state residency was the "critical link" justifying taxation. *Id.* at 802 n.25. Two justices dissented, focusing on the fact that the income at issue "was produced outside the state of Connecticut." *Id.* at 807 (McDonald, J., dissenting).
- In *Linn v. Department of Revenue*, 2 N.E.3d 1203, 1209 (Ill. App. Ct. 2013), the Illinois Appellate Court favorably cited Connecticut's *Gavin* decision and held that the critical link between a state and a trust for tax purposes is the residence of the beneficiary.[6]

In contrast, the courts of five states (including the North Carolina Supreme Court in this case) have concluded that the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency:

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[6] *Linn* ultimately held that the state could not tax a trust merely because the trust's settlor had been an Illinois resident. 2 N.E.3d at 1210.

- In *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490, 491 (N.Y. 1964), the New York Court of Appeals held that the Due Process Clause prohibited New York from taxing the income of a trust administered in Maryland. The court reached this conclusion even though the trust beneficiary was a New York resident.
- In *Potter v. Taxation Division Director*, 5 N.J. Tax 399, 405 (N.J. Tax Ct. 1983), the New Jersey Tax Court held that 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."[7]
- In *Blue v. Department of Treasury*, 462 N.W.2d 762, 764 (Mich. Ct. App. 1990), the Michigan Court of Appeals held that only the presence of "the trustee [or] trust property . . . within the state" can justify taxation of a trust's income.
- The North Carolina Supreme Court concluded here that Ms. Kaestner's in-state residency could not justify taxing the Trust. App. 18a.
- A month after the North Carolina Supreme Court decided this case, the Minnesota Supreme Court likewise concluded that a beneficiary's in-state residence is not a sufficient basis for

[7] Part of the holding in *Potter* has been superseded by statute, as recognized in *Heico Corp. v. Taxation Div. Dir.*, 20 N.J. Tax 106 (N.J. Tax Ct. 2002). However, the New Jersey Tax Court continues to rely on *Potter*'s holding on trust taxation. *See Residuary Trust A v. Dir.*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013).

> taxation. The court reasoned that "the Minnesota residency of [the] beneficiary . . . does not establish the necessary minimum connection to justify taxing the trust's income." *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323, 331 (Minn. 2018). Two justices dissented, focusing on the beneficiaries' residency. *See id.* at 334 (Lillehaug, J., dissenting).

In sum, there is a direct split among nine state courts on an important constitutional question. This split has intensified recently, culminating in three decisions in the past five years. That direct split, by itself, shows the need for this Court's review.

II. The question presented has significant implications for the states.

The question presented has significant implications for the states in at least two ways. First, the question presented affects billions of dollars in state-tax revenue. Second, the question presented involves important principles of federalism.

A. The question presented affects an enormous amount of state-tax revenue.

In 2014 alone, trusts filed more than 2.7 million federal tax returns.[8] Collectively, those trusts

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[8] *See* Internal Revenue Service, *SOI Tax Stats—Fiduciary Returns—Sources of Income, Deductions, and Tax Liability—Type of Entity: 2014*, *available at* https://www.irs.gov/statistics/soi-tax-stats-fiduciary-returns-sources-of-income-deductions-and-tax-liability-by-type-of-entity.

This figure includes returns filed on behalf of complex trusts, simple trusts, grantor trusts, qualified-disability trusts, split-interest trusts, and pooled-income funds. It does not include reported income of more than $120 billion.[9] Taxes on these billions of dollars are a critical source for funding states' essential government services.

Nearly every state taxes trust income.[10] At least eleven states currently tax undistributed trust income when a trust beneficiary lives in the taxing state.[11] Until the state supreme court's decision in this case, North Carolina had assessed these taxes since 1923. *See* Act of Mar. 3, 1923, ch. 4, § 205, 1923 N.C. Sess. Laws 67, 128.

With decisions like the one in this case, however, the states collectively stand to lose hundreds of millions of dollars in state-tax revenue *annually*—losses that will reach billions of dollars over the next decade alone. In North Carolina, the Department has already received more than 450 contingent income-tax returns from trusts that are awaiting the outcome of this petition.

In short, the question presented has enormous implications for the fiscal health of many states.

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returns filed on behalf of decedents' estates, Chapter 7 bankruptcy estates, and Chapter 11 bankruptcy estates.

[9] *See id.*

[10] *2017 Trust Nexus Survey Covering General Trust Nexus Policies*, Daily Tax Rep. (BNA) No. 175, at 10–11 (Oct. 30, 2017).

[11] Those states (other than North Carolina) are Alabama, *see* Ala. Code § 40-18-1(33); California, *see* Cal. Rev. & Tax. Code § 17742(a); Connecticut, *see* Conn. Gen. Stat. Ann. § 12-701(a)(4); Georgia, *see* Ga. Code Ann. § 48-7-22(a)(1)(A); Missouri, *see* Mo. Rev. Stat. § 143.331(1)(b); Montana, *see* Mont. Admin. R. 42.30.101(16); North Dakota, *see* N.D. Admin. Code 81-03-02.1-04; Ohio, *see* Ohio Rev. Code Ann. § 5747.01; Rhode Island, *see* 44 R.I. Gen. Laws § 44-30-5(c); and Tennessee, *see* Tenn. Code Ann. § 67-2-110(a).

B. The question presented involves important principles of federalism.

As the Framers recognized, the states have always "possessed an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." The Federalist No. 32, at 197 (Alexander Hamilton) (Clinton Rossiter ed., 1961); *see also Wayfair*, 138 S. Ct. at 2096 (describing state taxes as a "valid exercise of the States' sovereign power").

This broad power to tax is a cornerstone of federalism. As Chief Justice Marshall noted in *McCulloch v. Maryland*, "the power of taxing the people and their property is essential to the very existence of government." 17 U.S. (4 Wheat.) 316, 428 (1819). He stressed that this power covers "[a]ll subjects over which the sovereign power of a state extends." *Id.* at 429.

Acting on these principles, this Court has cautioned that the "modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible." *Dows v. City of Chicago*, 78 U.S. 108, 110 (1871).

Now, however, five state courts have reached federal constitutional decisions that slight these principles of federalism. Those courts have rejected a common mode of trust taxation. They have also cast doubt on the constitutionality of that mode of taxation for the other states that have adopted it, as well as states that may consider assessing these taxes in the future. Together, these decisions mark "an extraordinary imposition by the Judiciary on States' authority to collect taxes and perform critical public functions." *Wayfair*, 138 S. Ct. at 2095 (describing the former "physical-presence rule" under the Commerce Clause).

As these points show, the question presented raises important fiscal concerns and involves important federalism principles.

III. This case offers the Court an opportunity to modernize its trust-taxation jurisprudence.

A. The absence of modern precedent on trust taxation has caused confusion.

It has been more than seventy years since the Court addressed the power of states to tax trusts. *See Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947); Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 Vand. L. Rev. 1945, 1968 (2014). Given the lack of contemporary guidance from the Court, state courts are confused over how to apply the Due Process Clause in the context of trust taxation.

Some state courts have looked to this Court's early decisions on trust taxation—decisions from the era of *Pennoyer v. Neff*, 95 U.S. 714. Other state courts, like the North Carolina Supreme Court in this case, have attempted to apply the Court's more recent due-process decisions. In both sets of cases, the courts' opinions have shown the need for more direct guidance from this Court.

Some state courts that have relied on older due-process precedents have followed this Court's 1929 decision in *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83. In *Safe Deposit*, this Court held that Virginia could not assess property taxes on trust property that was held in Maryland for a Virginia beneficiary. *Id.* The Court premised this holding on its assumption that the Due Process Clause does not allow multiple states to tax the same intangible property. *Id.* at 94.

Safe Deposit, however, does not involve a modern due-process analysis. It was decided under the rigid, presence-based regime of *Pennoyer v. Neff*. It was decided fifteen years before *International Shoe*, which replaced *Pennoyer*'s rigid test with the more flexible "minimum contacts" test. 326 U.S. at 316. It was also decided long before *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which rejected "formalistic tests" for assessing jurisdiction to tax.[12] *Id.* at 307–08 (eliminating the former "physical presence" rule under the Due Process Clause).

Furthermore, *Safe Deposit* was premised on the notion that the Due Process Clause prohibits double taxation—a prohibition that the Court later abandoned in *Curry v. McCanless*, 307 U.S. 357, 363 (1939). With that linchpin removed, *Safe Deposit* is no longer good law. *See, e.g.*, *Gavin*, 733 A.2d at 803 (noting that the double-taxation concern was "[c]entral to the Court's reasoning in *Safe Deposit*," but that this rationale "has long been abandoned as a limitation on taxation under the due-process clause"); *Kaestner*, 814 S.E.2d at 53 (Ervin, J., dissenting) (opining that *Safe Deposit* did not support, much less compel, the majority's decision); *see also McCullough*, 390 P.2d at 418 (acknowledging *Safe Deposit* without following it).

[12] Although both *International Shoe* and *Quill* were cases involving state taxes, neither case involved trusts, much less due-process limits on trust taxation. Thus, neither decision answers the question presented here.

Despite these points, a number of state-court majorities and dissents have followed *Safe Deposit*. *See Blue*, 462 N.W.2d at 764; *Fielding*, 916 N.W.2d at 330; *Fielding*, 916 N.W.2d at 337 n.4 (Lillehaug, J., dissenting); *Murphy*, 203 N.E.2d at 490. They have done so largely without asking whether *Safe Deposit* has been displaced by the Court's modern due-process decisions.

State courts that have relied on the Court's more modern due-process decisions have shown equal confusion.

The North Carolina Supreme Court's decision in this case is a prime example. The majority borrowed general principles from recent adjudicative-jurisdiction cases that are silent on trust taxation and the unique relationship between a trust and a beneficiary. App. 13a.

Most notably, the state supreme court relied on *Walden v. Fiore*, 571 U.S. 277, a case that decided whether two Nevada gamblers could bring a tort lawsuit in Nevada against a Georgia-based law enforcement agent who seized their gambling winnings in Georgia. The *Walden* Court explained that a plaintiff cannot use the forum contacts of a "third party"—there, the plaintiffs themselves—to justify personal jurisdiction over a defendant. *Id.* at 286.

Walden's rationale does not apply in the context of a trust and its beneficiaries, where the beneficiary is not a genuine third party. Unlike the brief interaction between the tortfeasor and the plaintiffs in *Walden*, the fiduciary relationship between a trustee and a beneficiary is enduring; indeed, such a relationship often lasts many decades. *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 480 (1985) (recognizing that long-term relationships can serve as a basis for jurisdiction, depending on the quality and nature of those relationships). And unlike the adverse relationship between the tortfeasor and the plaintiffs in *Walden*, the relationship between a trust and its beneficiaries is symbiotic. After all, the beneficiaries are why the trust exists. *See infra* p. 19.

In sum, neither the Court's pre-*International Shoe* decisions nor its modern decisions have resolved the question presented. The lack of on-point decisions has caused confusion among state courts.

B. *Wayfair* is a model for modernizing this Court's trust-taxation jurisprudence.

In the recent *Wayfair* decision, the Court updated its Commerce Clause jurisprudence to reflect present-day realities in the context of sales taxes. This case offers the Court a similar opportunity to modernize its due-process jurisprudence in the context of trust taxes.

In *Wayfair*, the Court reaffirmed *Quill*'s holding that a taxpayer "need not have a physical presence in a state to satisfy the demands of due process." *Wayfair*, 138 S. Ct. at 2084–85. The Court expressly rejected "arbitrary, formalistic" distinctions that lower courts had used to "prevent States from collecting taxes." *Id.* at 2094. The Court also condemned "judicially created tax shelter[s]." *Id.*

This case gives the Court a similar opportunity to modernize the constitutional analysis of trust taxation in ways that parallel *Wayfair*.

First, like *Wayfair*, this case presents an opportunity for the Court to reject "arbitrary, formalistic" distinctions that prevent states from assessing taxes. The North Carolina Supreme Court's formalistic rationale—the idea that trust beneficiaries' contacts with a taxing state are not contacts of the trust itself—is an outdated notion, reminiscent of the physical-presence rule that was retired in *Wayfair*.

The question presented here calls for a more flexible approach to trust taxation—one that expressly recognizes that a beneficiary is no stranger to a trust. This approach is consistent with the Court's existing due-process jurisprudence, which requires only "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill*, 504 U.S. at 306 (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954)).

In the context of trust taxation, the required "minimum connection" is the residency of the beneficiary in the taxing state. This residency creates a "definite link" between the trust and the taxing state; indeed, if not for the in-state beneficiary who consumes the resources of the taxing state, the trust itself could not exist. *See* Bogert, *supra*, § 543 (noting that a trust fails for lack of a beneficiary); Restatement (Third) of Trusts § 44 (Am. Law Inst. 2003) (same).

The definite link is even stronger when one considers the vested interest that the beneficiary has in the trust. This Court has characterized that interest as an "estate in and to property" of the trust. *Blair v. Comm'r*, 300 U.S. 5, 14 (1937) (quoting *Brown v. Fletcher*, 235 U.S. 589, 599 (1915)). In other words, the trustee has legal ownership of property held in the trust, but the beneficiary enjoys equitable ownership of that property—"an actual property interest in the subject-matter of the trust." *Commonwealth v. Stewart*, 12 A.2d 444, 446–47 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941); *see also* Bogert, *supra*, § 114.

As these points show, the North Carolina Supreme Court's formalistic "separateness" theory clashes with this Court's modern due-process jurisprudence and overlooks the essential nature of trusts. This case presents an ideal opportunity for the Court to reject these arbitrary, formalistic distinctions and adopt an approach that is more appropriate for analyzing trust taxation under the Due Process Clause.

Second, like *Wayfair*, this case presents an opportunity for the Court to eliminate a "judicially created tax shelter." 138 S. Ct. at 2094.

Five state courts have now concluded that taxing trusts based on trust beneficiaries' in-state residency is unconstitutional. In those five states, beneficiaries like Ms. Kaestner can establish residency, consume state resources, and accept other protections from the state, while income earned for their benefit goes untaxed. *See id.* at 2096 (observing that state taxes fund local police and fire departments, public roads, municipal services, local banking, and the court system for the benefit of residents); *see also Gavin*, 733 A.2d at 795 (recognizing that trusts benefit from states' protection of their beneficiaries); *McCullough*, 390 P.2d at 419 (same).

These state benefits are not hypothetical. For example, one of the Kaestner Trust's main purposes was to provide for Ms. Kaestner's education. That purpose was fulfilled when Ms. Kaestner earned a master's degree at UNC-Chapel Hill. Her university education was subsidized by North Carolina's taxpayers. And if Ms. Kaestner died in the absence of contingent trust beneficiaries, her interest would pass through North Carolina's probate system—another benefit funded by North Carolina's taxpayers.

Worse still, the five state-court decisions that have rejected jurisdiction have enabled beneficiaries to avoid paying state taxes *altogether*. Beneficiaries like Ms. Kaestner can now accumulate income in their trusts over several decades, avoid taxes on that income, and then, before taking a distribution from their trusts, simply move—even temporarily—to a state like Florida that does not assess income taxes. Nothing would stop these beneficiaries from returning the following year to their home state to resume residency after taking tax-free distributions from their trusts.

As one commentator put it, decisions like the one in this case "facilitate an extraordinary stratagem by which wealthy individuals are able to avoid all state income taxes on investment income through the use of a carefully crafted out-of-state trust." Schoenblum, *supra*, at 1997.

Under any notion of "fair play and substantial justice," *Int'l Shoe*, 326 U.S. at 320, this "judicially created tax shelter" is one that warrants elimination. *Wayfair*, 138 S. Ct. at 2094.

* * *

The Due Process Clause should not have different meanings across nine states, especially when billions of dollars in state-tax revenue hang in the balance. Without guidance from this Court, the split at issue here will continue to worsen, with serious consequences for the states.

For these reasons, the question presented warrants this Court's review.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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