No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

PETITIONER'S BRIEF

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

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

JOSHUA H. STEIN
Attorney General

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

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

QUESTION PRESENTED

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

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INTRODUCTION

Kimberley Rice Kaestner is the beneficiary of a trust that her father created to transfer his wealth. During the tax years at issue in this case, Ms. Kaestner's trust generated millions of dollars of income. If the trust prevails here, however, it will avoid state income taxes on nearly all of that income.

That outcome is possible only because of a mistaken interpretation of the Due Process Clause. The North Carolina Supreme Court held here that when a trust's beneficiary lives in a state, that residency does not establish the connection with the state that due process requires.

That interpretation of the Due Process Clause results in a judicially created tax shelter.

Here, Ms. Kaestner's family skillfully exploited this tax shelter. The trust at issue had a trustee from Connecticut, a state that does not tax trusts under the circumstances here. Thus, the trust paid no income taxes in Connecticut.

In North Carolina, where Ms. Kaestner and her children lived, the trust did face state taxes, but it challenged the state's trust-tax statute on due-process grounds. The trust argued that North Carolina—the state where Ms. Kaestner lived, raised a family, and attended a state-funded university—lacked a "minimum connection" to her trust.

The North Carolina Supreme Court accepted the trust's arguments. It reasoned that Ms. Kaestner is a mere "third party" to the trust that bears her name. On that theory, the court held that Ms. Kaestner's extensive North Carolina contacts did not count for due-process purposes. After concluding that the Kaestner Trust was not physically present in North Carolina, the court held that the Due Process Clause barred North Carolina from taxing the trust's income.

This *Pennoyer*-like formalism has no place in modern due-process doctrine. *See Pennoyer v. Neff*, 95 U.S. 714, 733–34 (1878). This Court's modern teachings on due process elevate fairness over formalism.

Under a fairness-based analysis, as well as settled principles of trust law, a beneficiary is the central figure in a trust. Serving the beneficiary's interests is the trust's reason for being. For these reasons, when a trust beneficiary lives in a state and benefits from the state's services, her trust has the required connection with that state.

Upholding taxes on that basis follows not only from modern due-process analysis, but also from federalism. This Court has long recognized the importance of the states' authority to tax. The due-process rule that the state supreme court adopted here, however, lays waste to the states' taxing authority. That rule invalidates a taxing approach that North Carolina has followed for almost a century.

The state supreme court's holding, moreover, creates a tax shelter that few large trusts will be able to resist. To avoid state income taxes under that holding, all one needs to do is select a trustee in a state with no trust-income tax. Trusts in this country earn about 120 billion dollars of income every year. With that much income at stake, constitutionalizing a tax shelter would deal a serious blow to the fiscal health of many states.

Nothing in the Due Process Clause requires such a result. Under this Court's teachings, due process does not bar the states from taxing trusts based on a trust beneficiary's residency.

Because the state supreme court reached the opposite conclusion, its decision should be reversed. The tax shelter here deserves the same fate that befell a similar judicially created tax shelter last Term. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2094 (2018).

OPINIONS BELOW

The opinion of the Supreme Court of North Carolina (Pet. App. 1a–26a) is reported at 814 S.E.2d 43 (N.C. 2018).

The opinion of the North Carolina Court of Appeals (Pet. App. 27a–40a) is reported at 789 S.E.2d 645 (N.C. Ct. App. 2016).

The state trial court's decision (Pet. App. 41a–69a) is available on Westlaw. *See Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015).

JURISDICTION

The judgment below, affirming a final judgment on constitutional grounds, was entered on June 8, 2018. Pet. App. 1a. The petition for certiorari was filed on October 9, 2018, and granted on January 11, 2019. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

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.

The North Carolina tax statute at issue states, in relevant part:

> The tax imposed by this Part applies to the taxable income of estates and trusts as determined under the provisions of the [United States Internal Revenue] Code except as otherwise provided in this Part. 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, [subject to certain adjustments]. The tax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to

> the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State. . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.

N.C. Gen. Stat. § 105-160.2 (2017).

STATEMENT

I. Background

Eleven states tax trusts, in whole or in part, based on trust beneficiaries' in-state residency.[1]

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

II. The trusts at issue

In 1992, Joseph Lee Rice, III, created the Rice Family Trust to transfer wealth to his descendants. Pet. App. 2a. Mr. Rice referred to this trust as a "family asset." App. 51. He named his three children, including his daughter, Kimberley Rice Kaestner, as the trust's beneficiaries. Pet. App. 2a–3a.

Mr. Rice appointed William B. Matteson, a lawyer, as the Rice Family Trust's trustee. *See* Pet. App. 2a. Mr. Rice directed Mr. Matteson to distribute the trust's

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1 Those states (besides North Carolina) are Alabama, *see* Ala. Code § 40-18-1(33); California, *see* Cal. Rev. & Tax. Code § 17742(a); Connecticut, *see* Conn. Gen. Stat. § 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).

2 *See* Act of Mar. 3, 1923, ch. 4, § 205, 1923 N.C. Sess. Laws 67, 128.

assets “liberal[ly]” to “meet the needs of [the trust’s] [b]eneficiaries.” App. 51.

In 1997, Ms. Kaestner moved to North Carolina, where she and her husband raised a family. *See* Pet. App. 2a–3a.

In 2002, while Ms. Kaestner was living in North Carolina, the Rice Family Trust was divided informally into three separate shares. One of these three shares was for the benefit of Ms. Kaestner and her children. Pet. App. 3a.

In 2005, Mr. Matteson stepped down as the trustee of the Rice Family Trust. He was succeeded by David Bernstein, a lawyer at Debevoise & Plimpton LLP, the law firm that represents the Rice and Kaestner families. *See* Pet. App. 2a–3a; App. 41, 93.

Mr. Bernstein, by his own description, is “not a trust and estate lawyer.” App. 92. Even so, he has another attribute that makes him a useful trustee: He is a resident of Connecticut, Pet. App. 2a, a state that does not tax trust income based on a trustee’s residency alone.[3]

Soon after Mr. Bernstein became the trustee of the Rice Family Trust, he used Ms. Kaestner’s share of that trust to form a new trust: the Kimberley Rice Kaestner 1992 Family Trust, the respondent in this case. Pet. App. 3a. The Kaestner Trust was established

[3] *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

for the benefit of North Carolinians: Ms. Kaestner and her children. *See* Pet. App. 3a.[4]

The trust instrument names Ms. Kaestner and her children as the Trust's beneficiaries. Pet. App. 44a.[5] Throughout the tax years at issue, 2005 to 2008, these beneficiaries lived in North Carolina. Pet. App. 3a.

During the tax years at issue, Mr. Bernstein administered the Trust to satisfy Ms. Kaestner's needs. He and Ms. Kaestner communicated by phone, by e-mail, by mail, and in person. *See* App. 106; N.C. R. pp. 177, 217. At times, Mr. Bernstein and Ms. Kaestner would have "a number of calls in a couple weeks." N.C. R. p. 177.

On at least two occasions, Mr. Bernstein met with Ms. Kaestner in New York to discuss trust business. They discussed, among other topics, whether Ms. Kaestner wanted to receive distributions of her trust's income. Pet. App. 4a; App. 106.

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4 From this point on, this brief uses the terms "the Trust" and "the Kaestner Trust" to refer to the Kimberley Rice Kaestner 1992 Family Trust. As far as the Department is aware, and as far as the record here shows, the same trust instrument that formed the Rice Family Trust also governs the Kaestner Trust. App. 44–75.

5 The Trust has referred to Ms. Kaestner as its "sole primary beneficiary." Plaintiff-Appellee's Brief at 2, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018) (No. 307PA15-2). In references to the facts here, this brief uses the term "the beneficiary" to refer to Ms. Kaestner, unless the context requires a more specific reference.

Ms. Kaestner also received accountings in North Carolina on the financial status of her trust. *See* Pet. App. 4a.

During the tax years at issue, the assets of the Kaestner Trust totaled about thirteen million dollars. App. 118. Mr. Bernstein, however, did not make any distributions of trust income or trust principal during those years. Pet. App. 3a. Instead, the Trust accumulated income for Ms. Kaestner's benefit. *See* Pet. App. 3a–4a.

At some point between late 2008 and January 2009, Ms. Kaestner asked Mr. Bernstein for a loan from the Trust's assets, so she could pursue a commodities investment. *See* Pet. App. 3a; App. 99–100, 113. She received a loan of $250,000 from the Trust's assets in January 2009, the first month after the tax years at issue. Pet. App. 3a. Ms. Kaestner was a North Carolinian then as well. The Trust made the loan at the lowest interest rate that the IRS allows without imposing a gift tax. *See* Pet. App. 46a–47a.

In June 2009, Ms. Kaestner turned 40. Pet. App. 3a. The trust instrument provided that when Ms. Kaestner turned 40, the Trust would terminate and its assets would be distributed to her. Pet. App. 3a. Before Ms. Kaestner turned 40, however, she talked with her father and Mr. Bernstein about whether she should receive this distribution. Pet. App. 3a–4a. Ms. Kaestner ultimately decided that she would rather wait for the distribution. Pet. App. 3a–4a.

Following Ms. Kaestner's wishes, Mr. Bernstein did not distribute the assets of the Trust to Ms. Kaestner in 2009. Instead, he "decanted" most of those assets into yet another trust that was created for her benefit.[6] Pet. App. 4a.

III. The taxes on the Kaestner Trust

Over the tax years at issue, the Kaestner Trust and its predecessor trust sought to avoid state income taxes in every state that might have imposed such a tax.

The Rice Family Trust used Mr. Matteson as its first trustee. In 1995, Mr. Matteson moved to Florida. App. 11. Florida has no income tax, so the Rice Family Trust avoided all state income taxation there.

In 2005, the Florida trustee was replaced with Mr. Bernstein, a Connecticut resident. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone. *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i). By having Mr. Bernstein serve as trustee, the Rice Family Trust and the Kaestner Trust avoided state income taxes in Connecticut.

They avoided most state income taxes in New York as well. After Mr. Bernstein became the trustee, he filed an amended trust-tax return for the Rice Family

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[6] Decanting a trust means distributing "some or all of a trust's assets to another trust." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 567, at 138 (Supp. 2018).

Trust in New York for 2005. That amended return invoked the Due Process Clause, stating that since Mr. Matteson's move to Florida in 1995, the Rice Family Trust "ha[d] been administered solely by a trustee domiciled outside the State of New York." App. 76. Mr. Bernstein went on to argue that the Rice Family Trust's "only contacts with [New York] in 2005 were the domicile of its [grantor] at the time the trust was created many years earlier and a negligible amount of income from intangible assets" in New York. App. 78.

Those due-process arguments relieved the Rice Family Trust from paying taxes on all of its income except $2,165 from New York sources. *See* App. 76–79. The trust's total income in 2005 was about $2,350,000. *See* App. 76–79. On virtually all of that income, the trust, by having Florida and Connecticut trustees, paid no state income taxes in New York.

In North Carolina, the Kaestner Trust sought to avoid state income taxes as well. Those efforts led to this lawsuit.

From 2005 through 2008, as noted above, the beneficiaries of the Kaestner Trust—Ms. Kaestner and her three children—were North Carolina residents. Pet. App. 3a–4a. The Trust earned millions of dollars of income during those years. Under North Carolina's trust-tax statute, that income generated a tax liability of about $1,280,000. The Trust paid these taxes under protest, then sued for a refund.

When the Trust sued North Carolina, it did not deny New York residency, as it had done in New York. Instead, in its North Carolina complaint, the Trust alleged that it was "a trust with a situs in New York." App. 9.

IV. The proceedings below

The Kaestner Trust brought this lawsuit as a constitutional challenge in state court.[7] Among its claims, the Trust asserted an as-applied challenge under the Due Process Clause of the Fourteenth Amendment. Pet. App. 4a–5a. In support of that challenge, the Trust alleged that it lacked a constitutionally sufficient connection with North Carolina. Pet. App. 4a–5a.

The state trial court concluded that North Carolina's assessment of taxes on the Trust violated the Due Process Clause.[8] Accordingly, the court ordered a refund of the taxes at issue. Pet. App. 69a.

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[7] The Tax Injunction Act, 28 U.S.C. § 1341 (2012), required Ms. Kaestner's Trust to file this lawsuit in state court. The Act 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." *Ibid.*

[8] The Trust also pursued a Commerce Clause claim. The state trial court ruled in the trust's favor on that ground as well, holding that the court's due-process reasoning also showed a violation of the dormant Commerce Clause. Pet. App. 68a–69a. Neither of the state appellate courts addressed that part of the trial court's decision. *See* Pet. App. 7a–8a, 40a.

The North Carolina Court of Appeals affirmed. Pet. App. 27a.

In a 6-1 decision, the North Carolina Supreme Court affirmed the decision of the court of appeals. Pet. App. 2a. Applying the Due Process Clause, the court held that the in-state residency of trust beneficiaries is not a constitutionally sufficient connection with a state.

The court started its analysis by reasoning that a trust is an entity separate from its beneficiaries—in other words, that beneficiaries are third parties to a trust. Pet. App. 13a. Next, the court observed that third parties' contacts with a forum state do not count for due-process purposes. Pet. App. 13a. Finally, the court merged those two points and concluded that the North Carolina residency of the Kaestner Trust's beneficiaries does not establish any connection between the Trust and North Carolina. On that basis, the court held that North Carolina's trust-tax statute was unconstitutional as applied to the Trust. Pet. App. 18a.

Justice Sam J. Ervin, IV, dissented. In his opinion, he criticized the majority's "formalistic, presence-focused" analysis of due process. Pet. App. 24a. He opined that this Court's due-process decisions require a wider-ranging analysis of the Trust's connection with North Carolina—an analysis that gives weight to the in-state residency of the Trust's beneficiaries. Pet. App. 24a. 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 jurisdiction to tax. Pet. App. 24a.

SUMMARY OF ARGUMENT

The Due Process Clause does not bar a state from taxing a trust whose beneficiaries live in that state. Prohibiting those taxes, as the state supreme court did here, would harm the states in ways that the Due Process Clause does not compel.

To establish a due-process violation here, the Trust has the burden of satisfying two elements.

- First, the Trust must show that North Carolina lacks a "minimum connection" with "the person, property or transaction it seeks to tax." *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954)).

- Second, the Trust must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.' " *Quill*, 504 U.S. at 306 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).

Here, the Kaestner Trust cannot satisfy either of these elements.

First, Ms. Kaestner's residency in North Carolina establishes the required connection with the state.

The "minimum connection" standard centers on fairness, not formalism. *See infra* pp. 20–22. Indeed, this Court has specifically warned against using "formalistic tests" to assess jurisdiction to tax. *Quill*, 504 U.S. at 30.

Under a fairness-based analysis, a trust has the required connection with a taxing state when a trust beneficiary lives in that state. A trust, after all, is not a distinct entity like a corporation. Instead, it is just an abstraction that describes a fiduciary relationship between people. *See Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016).

Because a trust has no entity status, the state supreme court erred by demanding connections between the Kaestner Trust "itself" and North Carolina. Pet. App. 18a. For purposes of due-process connections with the states, a trust has no "self."

Instead, the only way a trust can make contact with a state is through the trust's constituents—the grantor, the trustee, and the beneficiary. That conclusion follows not only from trust law, but also from *Greenough v. Tax Assessors*, 331 U.S. 486 (1947), and *Americold*, 136 S. Ct. 1012. *See infra* pp. 25–28.

Out of the three constituents in a trust, trust beneficiaries have the most important jurisdictional contacts. Under trust law, the beneficiary is the central figure in the trust relationship—the trust's reason for being. *See infra* pp. 29–30. As these points show, the state supreme court erred by treating Ms. Kaestner as a "third party" to the trust that bears her own name.

Once formalism is cast aside, the analysis here becomes simple. Ms. Kaestner and her children lived in North Carolina throughout the tax years at issue. North Carolina offered them wide-ranging protection and services—benefits that spared the Trust from having to pay for equivalent services. Those benefits and protections made it only fair for North Carolina to demand a return in the form of trust-income taxes. *See infra* pp. 34–37.

For all these reasons, North Carolina has far more than a "minimum connection" with the Kaestner Trust. The state's connection with the Trust satisfies the first element under *Quill*.

The tax here also satisfies the second element under *Quill*. The tax was "rationally related to values connected with" North Carolina. *Quill*, 504 U.S. at 306. One hundred percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians.

In sum, due process does not justify the doctrine that the Trust seeks here: a rule that the only state that can tax trust income is the state where a trustee lives.

That rule would construct a "judicially created tax shelter" of the first magnitude. *Wayfair*, 138 S. Ct. at 2094. If that rule became the law, any rational grantor would choose a trustee in a state without trust-income taxes. That choice, moreover, would not require much effort: Trust companies and online services stand ready to assign favorably located trustees.

These tax-reducing strategies are far from hypothetical. In this case, the Rice and Kaestner families used similar strategies. The families' trusts worked with trustees in Florida and Connecticut, states with no applicable trust-income taxes.

Trusts generate 120 billion dollars of our nation's income every year. In view of that figure, an endorsement of the tax shelter the Trust seeks here would harm the fiscal health of many states. *See infra* pp. 41–43.

For these reasons and others, the Due Process Clause does not mandate the judicially created tax shelter that the Kaestner Trust is seeking.

ARGUMENT

I. The Due Process Clause does not prohibit a state from taxing a trust with beneficiaries in that state.

A. The two-part test in *Quill* governs the due-process analysis here.

As the Framers recognized, the states have always had "an independent . . . 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).

The states' authority 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). This power covers "[a]ll subjects over which the sovereign power of a state extends." *Id.* at 429.

Acting on these principles of federalism, 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. (11 Wall.) 108, 110 (1871).

This Court's modern case law on tax jurisdiction embraces these principles of federalism. As recently as last Term, the Court described state taxes as a "valid exercise of the States' sovereign power." *Wayfair*, 138 S. Ct. at 2096.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court applied the Due Process Clause consistently with the above principles. The Court held that, in a due-process challenge to a tax, the taxpayer must satisfy two elements. *Id.* at 306.

First, the taxpayer must show that the taxing state lacks even a "minimum connection[] between [the] state and the person, property or transaction it seeks to tax." *Ibid.* (quoting *Miller Bros.*, 347 U.S. at 345).

Second, the taxpayer must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.'" *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

Both of these tests center on "fundamental fairness." *Quill*, 504 U.S. at 312. To test for fairness, this Court asks whether the state's exercise of jurisdiction is related to the benefits and protections that the state has provided—that is, "whether the state has given anything for which it can ask [for taxes in] return." *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24–25 (2008) (quoting *ASARCO Inc. v. Idaho Tax Comm'n*, 458 U.S. 307, 315 (1982)).

This fairness-based analysis has replaced the rigid, presence-focused analysis that prevailed in the years after *Pennoyer*, 95 U.S. 714. In *Quill*, the Court eliminated the "physical presence" rule under the Due Process Clause. *Quill*, 504 U.S. at 308. The Court also warned against using other "formalistic tests" to assess jurisdiction to tax.[9] *Id.* at 307.

Just last Term, the Court underscored these principles in *Wayfair*, 138 S. Ct. 2080. 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." *Id.* at 2093 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985)). The

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[9] This shift away from presence-based tests parallels developments in the area of jurisdiction to adjudicate. *See*, *e.g.*, *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 319 (1945); *see also* *Daimler AG v. Bauman*, 134 S. Ct. 746, 761 n.18 (2014) (noting this shift in adjudicative-jurisdiction doctrine).

Although tax jurisdiction parallels adjudicative jurisdiction in many respects, the two are not identical. *See Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). As Justice Scalia discussed in *Quill*, tax jurisdiction resembles prescriptive jurisdiction: a state's power "to make its law applicable to the activities, relations, or status of persons, or the interests of persons in things." Restatement (Third) of Foreign Relations Law § 401 (Am. Law Inst. 1987); *see Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). Adjudicative jurisdiction, in contrast, describes a state's power "to subject persons or things to the process of its courts or administrative tribunals, whether in civil or in criminal proceedings, whether or not the state is a party to the proceedings." Restatement (Third) of Foreign Relations Law § 401.

Because adjudicative jurisdiction and tax jurisdiction play different roles, one should take care before applying precedents from one sphere in the other sphere. *Cf.* Pet. App. 13a, 17a (relying extensively on *Walden v. Fiore*, 571 U.S. 277 (2014), and *Hanson v. Denckla*, 357 U.S. 235 (1958), decisions on adjudicative jurisdiction).

Here, there is no dispute over adjudicative jurisdiction, because Ms. Kaestner's Trust sued the Department in North Carolina's courts.

Court also condemned "arbitrary, formalistic" distinctions that lower courts had used to "prevent States from collecting taxes." *Wayfair*, 138 S. Ct. at 2092.

Through these decisions, the Court has repeatedly cautioned that a proper due-process analysis of taxation centers on fairness, not formalism. That movement away from formalism is especially important in this case.

B. Under the Due Process Clause, a trust beneficiary's contacts with a state justify taxing her trust.

1. For due-process purposes, a trust is an abstraction, not a distinct legal entity.

Here, the state supreme court reasoned that for the Kaestner Trust to have a constitutionally valid connection with North Carolina, the connection would have to involve the "trust itself." Pet. App. 18a. The court's reasoning overlooked this Court's analysis of the relationship between states and trusts.

American law has traditionally refused to recognize a trust as "a distinct legal entity." *Americold*, 136 S. Ct. at 1016.

Instead, this Court has described a trust as an "abstraction." *Greenough v. Tax Assessors*, 331 U.S. 486, 493 (1947) (quoting *Anderson v. Wilson*, 289 U.S. 20, 27 (1933)). That description reflects the reality that a trust is "not a legal person." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 712, at 273 (2009) [hereinafter Bogert]; *cf. Taylor v. Davis' Adm'x*, 110 U.S. 330, 335 (1884) ("[t]he trust estate cannot promise").

In *Americold*, the Court clarified the nature of a trust. 136 S. Ct. at 1016. The Court explained that a trust is merely a "'fiduciary relationship' between multiple people."[10] *Ibid.* (quoting Restatement (Second) of Trusts § 2 (1957)); *accord* Restatement (Third) of Trusts § 2 (Am. Law Inst. 2012).

That fiduciary relationship begins when the grantor of an irrevocable trust contributes property to the trust. Unif. Trust Code § 103 (Unif. Law Comm'n 2000); Bogert, *supra*, § 1, at 8–10. The people in the fiduciary relationship itself are the trust beneficiary and the trustee. Bogert, *supra*, § 1, at 11.

The beneficiary is the person for whose benefit the trustee holds the trust property. *Ibid*. "The trustee is the individual or entity (often an artificial person such as a corporation) that holds the trust property for the benefit of [the beneficiary]." *Id.* at 7. These two people—in some cases, multiple people—are the ones who make up the trust relationship. *Americold*, 136 S. Ct. at 1016.

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[10] Because of the abstract nature of a trust, *Americold* held that a real-estate-investment trust does not have a distinct entity-level citizenship for purposes of diversity jurisdiction. 136 S. Ct. at 1016.

When the North Carolina Supreme Court applied due-process analysis here, it misunderstood how that analysis applies to trusts. The court treated the Kaestner Trust as a separate legal entity. Pet. App. 12a. Taking this "separate entity" theory further, the court held that, for due-process purposes, Ms. Kaestner is a "third party" to her trust. Pet. App. 13a. The court cited *Brooke v. City of Norfolk*, 277 U.S. 27 (1928), for the proposition that a trust and its beneficiaries are separate for tax purposes. Pet. App. 12a–13a.

That "separateness" theory was rejected, however, in *Stone v. White*, 301 U.S. 532 (1937). There, in the context of a tax-refund claim, this Court equated trusts' interests with beneficiaries' interests. The Court held that when a trust pays a tax, "only [the beneficiary] is ultimately burdened." *Id.* at 538. Thus, the Court refused to "shut its eyes to the fact that in the realm of reality it [is] the beneficiary's money which [pays] the tax." *Id.* at 535.

When the state supreme court held that Ms. Kaestner is a mere third party to her trust, the court also cited *Hanson v. Denckla*, 357 U.S. 235 (1958). *Hanson*, however, does not control here. The issue there was adjudicative jurisdiction over a *trustee*, not tax jurisdiction over a trust. *Id.* at 253. The *Hanson* Court had no occasion to decide whether a beneficiary's residency in a state allows that state to tax the beneficiary's trust income.

Based on these and other errors, the state supreme court treated a trust beneficiary as a stranger to the trust that bears her name. That kind of formalism has no place in a modern due-process analysis, which centers on fairness. *See supra* pp. 20–22. Under a fairness-based analysis, it makes no sense to limit the inquiry to the jurisdictional contacts of a mere abstraction.

2. The contacts that count for due-process purposes are the contacts of a trust's constituents.

Because a trust is an abstraction, it cannot have physical contacts with a state. *See Americold*, 136 S. Ct. at 1016 (noting that the "[trust] relationship was not a thing that could be haled into court"). Instead, a trust makes jurisdictional contact with states through the people who make up the trust relationship.

The Court established this principle in *Greenough v. Tax Assessors*, 331 U.S. 486 (1947). There, the Court considered a question closely related to the question here: whether the Due Process Clause barred Rhode Island from taxing a trust based on the in-state residency of a trustee. *See id.* at 488–89. The Court held that the Due Process Clause did not bar such a tax. *Id.* at 498.

The *Greenough* Court began by analyzing the unique, abstract nature of trusts. *Id.* at 493. The Court pointed out that it has treated a trust as an abstraction, not as a separate entity. *Ibid.*

The federal tax code sometimes treats a trust as a separate taxpayer, but the Court described that treatment as a statutory decision, not as a constitutional command. *Id.* at 493–94 ("This is because Congress has seen fit so to deal with the trust.").

In contrast, when the Court assessed the jurisdictional contacts of the trust in *Greenough*, the Court did not treat the trust as a taxpayer with a "separate existence." *Id.* at 493. Instead, the Court focused on the jurisdictional contacts of the trust's *constituents*. *Id.* at 496.

Because of the facts in *Greenough*, the constituent at issue was a trustee. *Id.* at 488. In that context, the Court held that a benefit to a trustee is a benefit to the trust abstraction itself. *Ibid.* Because of the unique relationship between a trust and its constituents, the Court recognized that a trustee's contacts with a state can justify taxing a trust. *Id.* at 496. Through that reasoning, the *Greenough* Court treated a trust and its constituents as inextricably intertwined.[11]

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[11] The same conclusion also flows from one of this Court's key decisions on adjudicative jurisdiction: *Burger King Corp. v. Rudzewicz*, 471 U.S. 462. There, the Court held that the nature and intensity of a relationship can justify a court's exercise of power over a person. *Id.* at 480.

The relationship between a beneficiary and her trust is far more intensive than the franchise relationship at issue in *Burger King*. A beneficiary is not a contractor with a trust; she is the trust's very heart. As shown below, the trust cannot exist without her. *See infra* pp. 29–30.

Greenough's approach is significant, because that decision departs from a *Pennoyer*-era decision on the due-process limits of trust taxation. *See Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929).

In *Safe Deposit*, the Court held that Virginia could not assess property taxes on trust property that was being held in Maryland for a Virginia beneficiary. *Id.* at 94. *Safe Deposit* applied a rigid, *Pennoyer*-era due-process test—one that turned on the literal taxpayer's "actual presence" in the taxing state. *Id.* at 92.

The taxpayer at issue in *Safe Deposit* was a trust. *Id.* at 90. Under *Pennoyer*-era reasoning, once the Court decided that the trust property itself was not physically present in the taxing state, the case was over. *Ibid.* The Court expressly declined to consider whether, in light of the trust relationship, the contacts of the trust's beneficiaries should count for due-process purposes. *See id.* at 92 ("We need not make any nice inquiry concerning the ultimate or equitable ownership of the [trust property] or the exact nature of the interest held by the [beneficiaries].").

Greenough—a case decided a generation after *Safe Deposit* and two years after *International Shoe*—shows how the Court's analysis of trust contacts has turned away from formalism. In *Greenough*, the Court did what it declined to do in *Safe Deposit*: It examined the nature of the trust relationship, rather than focusing on the literal taxpayer's physical presence. *See Greenough*, 331 U.S. at 493. By performing that analysis, the Court showed that the contacts of the people in the trust relationship count in a due-process analysis.

When one compares *Greenough* with *Safe Deposit*, it becomes clear that one decision involves a modern due-process analysis, and one does not. *Greenough*, with its emphasis on fairness, tracks a modern due-process analysis. *Safe Deposit*, with its formalistic, presence-based reasoning, clashes with this Court's modern teachings on due process.[12] *See supra* pp. 20–22 (discussing those teachings).

In the related context of adjudicative jurisdiction, this Court has cautioned that *Pennoyer*-era precedents "should not attract heavy reliance today." *Daimler*, 134 S. Ct. at 761 n.18. Discarding *Safe Deposit* and upholding *Greenough* would reinforce that caution.

In sum, the analysis here should follow the central point of *Greenough*: In trust-tax cases, the contacts of the people in the trust relationship are the contacts that matter.

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12 *Safe Deposit* is no longer good law for another reason as well: It is premised on the view that the Due Process Clause prohibits double taxation. 280 U.S. at 92. The Court later abandoned that view in *Curry v. McCanless*, 307 U.S. 357, 363 (1939). *See*, *e.g.*, *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 803 (Conn. 1999) (noting that concerns over double taxation were "[c]entral to the Court's reasoning in *Safe Deposit*," but that those concerns had "long been abandoned as a limitation on taxation under the due process clause").

3. A trust beneficiary is a constituent of a trust—indeed, the most important constituent.

As shown above, *Greenough* holds that trustees' in-state residency justifies state taxes on trusts.

That conclusion applies with even greater force when the state resident at issue is a trust beneficiary. As shown below, a beneficiary is not only another constituent of a trust; she is a trust's most important constituent. Because of a beneficiary's central role in a trust, her residency in a state forms the required link between the taxing state and the trust. *See Quill*, 504 U.S. at 327 (requiring such a link).

The beneficiary is a trust's reason for being. Under settled principles of trust law, a trust exists solely "for the benefit of its beneficiaries." Unif. Trust Code § 404 (Unif. Law Comm'n 2000). The trust abstraction is simply "incidental to and derivative of the purpose of benefiting the trust beneficiary." Kent D. Schenkel, *Trust Law & the Title-Split: A Beneficial Perspective*, 78 UMKC L. Rev. 181, 183 (2009). Indeed, a trust cannot exist without beneficiaries. *See* Restatement (Third) of Trusts § 44 (Am. Law Inst. 2012).

A trust beneficiary, moreover, has an ownership interest in trust property—a "right, title, and estate in and to" that property. *Commonwealth v. Stewart*, 12 A.2d 444, 447 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941). In contrast, a trustee's interest in trust property is "merely nominal, with real ownership remaining in the beneficiary." John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 181 (1997).

As these points show, a beneficiary is not just one of the people in the trust relationship; she is the *most important* person in that relationship.

4. The benefits and protections that states give a trust beneficiary justify taxing her trust.

Because of the central role that a beneficiary plays in a trust, the principle of *Greenough* applies equally to this case. Under that principle, a trust constituent's residency in a state connects the trust to the state. *See Greenough*, 331 U.S. at 495; *see also McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 419 (Cal. 1964) (same); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 802 (Conn. 1999) (same).

Another principle in *Greenough* applies here as well: The benefits and protections that a state gives a trust constituent justify taxing the trust.

In *Greenough*, the Court pointed out that the trust constituent at issue, the trustee, was "entitled to the same advantages from Rhode Island laws as [was] any natural person there resident." 331 U.S. at 495.

The Court also stressed the many benefits and protections that Rhode Island gave the trustee. The state offered the trustee all of the "benefits and protection inherent in the existence of an organized government," including the "privileges of citizenship" and "the protection of his domiciliary government." *Id.* at 493.

The Court held, moreover, that it did not matter whether the trust constituent actually used these benefits; all that mattered was that he had the opportunity to do so. *See ibid.* The Court upheld the tax at issue even though "nothing appeared as to any specific benefit or protection which the trustee had actually received." *Id*. at 495.

The benefits and protections that a state offers a trust beneficiary are even more important than the benefits that a state offers a trustee. *See id.* at 493–97 (citing those benefits).

The fulfillment of a trust's purpose—serving the trust beneficiary—"assumes solvent state and local governments." *Wayfair*, 138 S. Ct. at 2096. That purpose depends on the benefits that a state confers by maintaining "an orderly, civilized society." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

For example, if a beneficiary's home state did not protect "sound local banking institutions," a trust could not make secure distributions to the beneficiary. *Wayfair*, 138 S. Ct. at 2096 (quoting *Quill*, 504 U.S. at 328). More fundamentally, if the beneficiary did not receive the physical protection and security that her state government provides, including the "police and fire departments that protect [her]," she would be in no position to receive or enjoy her distributions. *Wayfair*, 138 S. Ct. at 2096; *see also* Ilya Somin, *Revitalizing*

Consent, 23 Harv. J.L. & Pub. Pol'y 753, 759 (2000) (describing the enormously expensive services that states provide).

Indeed, state benefits and protections relieve a trust from making outlays on its beneficiaries' behalf. For example, a common purpose of a trust is to pay for beneficiaries' education. Restatement (Third) of Trusts § 50 cmt. d(2) (Am. Law Inst. 2012). All states, however, offer free public schools to their school-age residents. Because a state offers that expensive service for free, a trust that has a duty to provide for the education of its beneficiaries need not spend thousands of dollars per year on private schools. Free education and other taxpayer-subsidized benefits allow a trust to save its income and garner investment returns.

The privileges that flow from a beneficiary's in-state residency "are inseparable from responsibility for sharing the costs of government." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937). As Justice Holmes famously observed, "taxes are what we pay for [a] civilized society." *Compania Gen. de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

This close relationship between state taxation and state protection of trust beneficiaries has led other state courts to uphold state trust taxes against due-process claims.

In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, for example, the Connecticut Supreme Court drew the same parallel to *Greenough* that this brief draws. *See* *supra* pp. 30–31. The court held: "[J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws[,] it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits." *Id.* at 802 (citing *Greenough*, 331 U.S. at 496).

Likewise, in *McCulloch v. Franchise Tax Board*, 390 P.2d 412, the California Supreme Court agreed that a beneficiary's home state can tax undistributed trust income. The court emphasized the protection that a state offers a trust during the years when the trust is accumulating income. During those years, the state gives the beneficiary "the interim protection of its laws so that [she] may ultimately obtain the benefit of the accumulated income." *Id.* at 419.

As these courts rightly held, a trust beneficiary's residency in a state gives her, and her trust, enormously valuable services and protection. Those services, plus the close connection between the beneficiary and the trust, establish the required connection between the state and the trust. *See Quill*, 504 U.S. at 306. That principle decides this case.

C. Ms. Kaestner's residency in North Carolina justifies the state's exercise of tax jurisdiction over her trust.

As shown above, the Trust's due-process challenge to North Carolina's trust-tax statute is governed by the two-part test that this Court announced in *Quill*. *See Quill*, 504 U.S. at 306; *supra* p. 20.

The statute satisfies both parts of the *Quill* test.

1. Ms. Kaestner's North Carolina residency satisfies the first element of *Quill*.

As applied to the Kaestner Trust, North Carolina's trust-tax statute satisfies the first element of the *Quill* test, the "minimum connection" element. As shown above, when a trust beneficiary lives in a state, so does her trust. Here, the beneficiaries of the Kaestner Trust were North Carolina residents during the tax years at issue.

As in-state residents, Ms. Kaestner and her children were offered all of the taxpayer-funded benefits and protections that come with residency in North Carolina. These benefits and protections parallel the benefits that, *Greenough* held, would justify the exercise of tax jurisdiction over a trust. 331 U.S. at 493–97; *supra* pp. 30–31.

Indeed, the case for taxation here is even stronger than in *Greenough*. There, the Court noted that the record did not show "any specific benefit or protection" that any trust constituent had actually received. *Greenough*, 331 U.S. at 495. Here, in contrast, Ms. Kaestner received wide-ranging benefits and protections from North Carolina. In fact, those state benefits replaced services that the Trust otherwise would have had to buy for Ms. Kaestner.

For example, one of the Trust's purposes was "to provide for [its beneficiaries'] education." App. 51. North Carolina gave Ms. Kaestner the opportunity to send her children to the state's excellent public schools at no charge. Indeed, the North Carolina Constitution secured the children's right to a free education in the public schools. N.C. Const. art. I, § 15 ("The people have a right to the privilege of education, and it is the duty of the State to guard and maintain that right."); *id.* art. IX, § 2(1) (mandating "free public schools").

Similarly, before the tax years at issue, Ms. Kaestner enrolled at the University of North Carolina at Chapel Hill and earned a master's degree. App. 81. North Carolina's taxpayers subsidized that public university. *See* N.C. Gen. Stat. §§ 116-4, -144. During the tax years at issue, if Ms. Kaestner wished to pursue further studies in the UNC system, those educational services were available to her at taxpayer-subsidized rates. *See* App. 81.

Another one of the Kaestner Trust's main purposes was to provide for the beneficiaries' health and welfare. App. 51. North Carolina shouldered that responsibility by giving Ms. Kaestner and her children all of the critical public-safety services needed to protect their health and welfare, including police and fire departments. *See Wayfair*, 138 S. Ct. at 2096. By taking on those responsibilities, North Carolina relieved the Trust of the enormous expense that equivalent services would have required.

The trust instrument also directed the trustee to help Ms. Kaestner if she "set[] up a business." App. 51. When Ms. Kaestner did so, North Carolina's state government stepped in again to help the Trust. Near the end of the tax years at issue, the Trust loaned Ms. Kaestner $250,000 to invest in commodities. Pet. App. 3a. That loan was facilitated by North Carolina's sound local banking institutions. *See Wayfair*, 138 S. Ct. at 2096. If the loan had generated any legal disputes, North Carolina's state courts and state laws were at hand to resolve those disputes. *See Greenough*, 331 U.S. at 495–97 (citing the availability of a state's legal system as a benefit to a trust).

In these ways and more, North Carolina benefited the Kaestners by maintaining the "orderly, civilized society" that made their lifestyle in North Carolina possible. *J.C. Penney*, 311 U.S. at 444.

In view of those benefits, as well as the inseparable relationship between Ms. Kaestner and her trust, her life in North Carolina establishes the required "minimum connection" between North Carolina and the Trust. That connection satisfies the first element under *Quill*.

2. North Carolina's limited tax satisfies the second element of *Quill*.

This case also satisfies the second element of *Quill*: North Carolina's taxation of the Trust's income was "rationally related to values connected with" the state. *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

The state supreme court did not reach this issue. *See* Pet. App. 10a ("[I]n this case we are concerned only with the first [*Quill*] requirement."). Even so, the record makes clear that the tax at issue satisfies the second element under *Quill*.

North Carolina taxed Ms. Kaestner's Trust only on income that was earned for Ms. Kaestner's benefit. North Carolina's statute taxes only "the amount of the taxable income . . . that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2. That narrowing language ensures that North Carolina's trust taxes are apportioned to match the interests held by North Carolina beneficiaries.

Here, 100 percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians. The Trust's own complaint alleged that, during the tax years at issue, the Trust's "current beneficiaries" were "Kimberly Rice Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina." App. 11. Thus, the share of the Trust's income that was connected with North Carolinians—and therefore connected with state services to those North Carolinians—was 100 percent. That was the share of the Trust's income that North Carolina taxed. *See Moorman*, 437 U.S. at 269.

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For these reasons, North Carolina's trust-tax statute, as applied to the Kaestner Trust, satisfies both elements of the *Quill* test. By reaching the opposite conclusion, Pet. App. 18a, the state supreme court made an error of federal constitutional law.

II. The Due Process Clause does not mandate the tax shelter that the Trust seeks here.

As shown above, when trust beneficiaries live in a taxing state, taxing trust income comports with due process. That conclusion becomes even clearer when one considers the harmful effects of the opposite rule that the state supreme court applied here. That rule is no better than a judicially created tax shelter—a type of doctrine that this Court has not hesitated to reject.

A. This case presents an opportunity for the Court to reject a judicially created tax shelter.

In the recent *Wayfair* decision, the Court condemned "judicially created tax shelter[s]" in the context of sales taxes. *Wayfair*, 138 S. Ct. at 2094. This case presents an opportunity for the Court to close an equally undesirable tax shelter: one that shelters massive trust income from state taxes.

In 2014 alone, trusts filed more than 2.7 million federal tax returns. Collectively, those trusts reported income of more than 120 billion dollars.[13]

[13] *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 returns filed on behalf of

Taxes on these billions of dollars are a critical source of funding for states' essential government services. At least eleven states currently tax undistributed trust income when a trust beneficiary lives in the taxing state. *See supra* p. 6 n.1.

The result the Trust seeks here, however, would make it possible for trusts to shelter their entire undistributed income from state income taxes. To achieve that result, all a trust would need to do is select a trustee in a state that does not tax trust income based on the trustee's residency—for example, Connecticut, where Mr. Bernstein lived, or Florida, where the predecessor trustee lived. *See supra* p. 10.

After selecting such an out-of-state trustee, beneficiaries like Ms. Kaestner could live in their home states, consume state resources, and accept other protections from the state on a tax-free basis.

Indeed, the ruling that the Kaestner Trust seeks would allow beneficiaries to avoid paying state income taxes forever. Beneficiaries like Ms. Kaestner could accumulate income in their trusts over several decades, avoid taxes on that income, and then, before taking a distribution from their trusts, simply move to a state without income taxes.

This tax shelter, if endorsed by this Court, would create an opportunity that few trusts could resist. As scholars agree, trusts are "particularly well suited" for

decedents' estates, Chapter 7 bankruptcy estates, and Chapter 11 bankruptcy estates.

"fiscal and regulatory avoidance." Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434, 479 (1998).

Unlike a human being, a trust can change its situs instantaneously. *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, 85 Cornell L. Rev. 1035, 1065 (2000). For example, "[f]or a California trust to relocate to Alaska, no individual has to change her domicile. A trust can relocate to Alaska without the use of bricks or mortar." *Ibid.*

Indeed, in this age of widespread online services, technology has made it remarkably easy to select a trustee in a state with no trust-income tax.[14] If a trust has an existing trustee in a state with unfavorable tax laws, a beneficiary can simply "request that the trustee resign." Jay A. Soled & Mitchell M. Gans, *Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century*, 72 Wash. & Lee L. Rev. 257, 277 n.129 (2015).

Because of these options, "mov[ing] an income-accumulation trust from a high income tax state to a low income tax state" is now "[o]ne of the most significant reasons for moving the situs of [an existing]

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14 For example, Charles Schwab Trust Company offers trustee services, promising to "leverag[e] the advantages of a favorable trust situs" in Nevada, a state that does not tax trust income. Charles Schwab Trust Company, https://www.schwab.com/public/schwab/investing/accounts_products/personal_trust_services (last visited Feb. 20, 2019).

trust." John Warnick & Sergio Pareja, *Selecting a Trust Situs in the 21st Century*, 16 Probate & Property 53, 57 (2002).

These techniques have led sophisticated planners to view trusts as "an income tax savior." Soled & Gans, *supra*, at 280. Empirical studies have shown that record amounts of assets have started flowing into trusts. *See* Robert Sitkoff & Max Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356, 391 (2005). A study that tracked the aggregate assets in trusts from 1985 through 2003 showed an increase from 400 billion dollars to 1.2 trillion dollars. *See ibid.*

In sum, the rule of constitutional law that the Trust seeks here would endorse "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." 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, 1997 (2014).

Such a rule would also end the states' ability to adopt tax approaches that would combat this tax-avoidance technique. Sound principles of federalism counsel against such a result. *See Dows*, 78 U.S. at 110 ("[The] modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible.").

Finally, constitutionalizing the tax shelter at issue here would deprive the states of hundreds of millions of dollars in tax revenue annually—losses that could reach a billion dollars in North Carolina over the next decade alone. Pet. 13.

Just last Term, this Court struck down a similar tax shelter, expressing concern over the "significant revenue losses to the States" that the tax shelter posed. *Wayfair*, 138 S. Ct. at 2093–94. The same ruling is justified here.

B. The Trust has actively sought to exploit the tax shelter at issue.

The facts of this case are a graphic example of the tax avoidance that would be produced by the rule the Trust seeks here.

During the tax years at issue, Ms. Kaestner expressed alarm to her trustee, Mr. Bernstein, about the number of expensive lawyers who were working to optimize her trust arrangements. N.C. R. p. 225. Mr. Bernstein reassured her that the legal fees would be "immaterial compared to the major tax savings" that the lawyering would achieve. N.C. R. p. 225.

If the Trust prevailed here, that outcome would prove Mr. Bernstein right.

As noted above, the predecessor of the Kaestner Trust, the Rice Family Trust, used a Florida trustee for a decade.[15] Florida has no income tax, so the trust avoided state income taxes in Florida during those years.

In 2005, the Florida trustee was replaced by a Connecticut trustee, Mr. Bernstein. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone.[16] Thus, the Rice Family Trust avoided state taxes in Connecticut as well.

Having avoided taxes in Connecticut, Mr. Bernstein then challenged New York's jurisdiction to tax the Rice Family Trust's income. He invoked the Due Process Clause, arguing that the trust lacked sufficient connections to New York. App. 76–79. On that basis, the trust avoided any residency-based taxes in the Empire State. Instead, it reported only $2,165 in income from New York sources—less than 0.1% of the trust's income that year. App. 76–79.

In North Carolina, in contrast, the Kaestner Trust faced a more significant challenge to its tax-avoidance efforts. North Carolina assessed income taxes on the Trust, because the Trust's beneficiaries lived in North Carolina and had access to extensive state services. *See supra* pp. 34–36.

To resist those taxes, the Trust filed this lawsuit. Although Mr. Bernstein had argued a few years earlier that the Trust's predecessor had insufficient

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15 Mr. Matteson, the original trustee, moved to Florida in 1995. App. 11.

16 *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

connections with New York, he argued to the North Carolina courts that the Kaestner Trust was "a trust with a situs in New York." App. 9.

Those tactics, so far, have enabled the Kaestner Trust and its predecessor to avoid state income taxes on virtually all of their income during the years described above.

During these years of maneuvering, there was one constant: North Carolina remained home to Ms. Kaestner, the beneficiary of the trust that bears her name.

If the Trust prevails here, it will have benefitted from Ms. Kaestner's consumption of North Carolina's services for years, yet will have avoided paying any trust-income taxes to fund those services. That outcome would clash with the "traditional notions of fair play and substantial justice" that shape modern analysis under the Due Process Clause. *International Shoe*, 326 U.S. at 320.

CONCLUSION

The state supreme court's decision should be reversed.

Respectfully submitted,

JOSHUA H. STEIN
Attorney General

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

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

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

February 22, 2019