No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

BRIEF OF WILLIAM FIELDING, TRUSTEE, AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

WALTER A. PICKHARDT
Counsel of Record
LAURA S. CARLSON
CAITLIN E. ABRAM
NICHOLAS J. NELSON
FAEGRE BAKER DANIELS LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-7000
walter.pickhardt@faegrebd.com

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

STATEMENT OF INTEREST OF AMICUS CURIAE[1]

Amicus is William Fielding, the trustee of four irrevocable inter vivos trusts (the "Fielding Trusts"). Minnesota taxed Mr. Fielding, as trustee, on the worldwide income of the Fielding Trusts under a law that defined a trust as a resident if the trust's *grantor* was domiciled in Minnesota at the time the trust became irrevocable. Minn. Stat. § 290.01, subd. 7b(a) (2014). The Minnesota Supreme Court held that Minnesota's rule—as applied to the Fielding Trusts, which had only "extremely tenuous" contacts with Minnesota—was unconstitutional under the Due Process Clause. *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323 (Minn. 2018). The Minnesota Commissioner of Revenue filed a petition for certiorari in *Fielding* on November 15, 2018, and the case is pending before this Court.

North Carolina in the instant case classifies a trust a resident based on a *beneficiary's* domicile in the state. Pet. App. 2a. Although Minnesota's residency statute does not reference the domicile of a trust beneficiary, the Minnesota Supreme Court in *Fielding* reviewed the fact that one of the beneficiaries was a Minnesota resident. That beneficiary (the grantor's only son) was a contingent *current* beneficiary of the trust that was formed for his primary benefit. (His

---

[1] Counsel for the parties were not in any way involved in authoring this brief. No person or entity, other than amicus and his counsel, made a monetary contribution to fund the preparation and submission of this brief. The parties to the case have filed blanket consents to the filing of amicus briefs.

interest was contingent because he had no vested right to distributions.) He was a contingent *remainder* beneficiary of the three similar trusts that were formed for the primary benefit of his sisters. (He might receive a distribution only if a sister predeceased him without surviving issue.) The Minnesota Supreme Court held that the son's domicile in Minnesota did not permit the state to treat any of the four trusts as residents.

Mr. Fielding submits this amicus brief in support of the Respondent because the decision here may affect the *Fielding* case.

SUMMARY OF ARGUMENT

A trust is not a legal entity capable of paying tax. Therefore, under North Carolina law, the liability to pay state income taxes falls upon the trustee, not the trust itself. N.C. Gen. Stat. § 105-160.2. That reality is central to a correct understanding of the issues in this case.

Petitioner agrees that a trust is "just an abstraction that describes a fiduciary relationship." Pet. Br. 16. However, ignoring that the legal duty to pay the tax is on the trustee, Petitioner claims that due process minimum contacts can be provided by *any* of "the trust's constituents—the grantor, the trustee, and the beneficiary." *Id*. When a similar argument was advanced in a case involving adjudicatory jurisdiction over a trust, this Court described the position taken by Petitioner in this case as a "non-sequitur." *Hanson v. Denckla*, 357 U.S. 235, 254 (1958).

Hanson involved a trust dispute in a Florida court. The beneficiaries were Florida residents. The grantor was a Florida resident at her death. The trustee, who was an indispensable party to the trust litigation, was located in Delaware. Applying the Due Process Clause, this Court held that connections to Florida provided by the beneficiaries and the grantor were irrelevant. The relevant minimum contacts were those of the trustee, and because the trustee had not purposefully availed itself of the privilege of conducting activities within Florida, there was no jurisdiction in Florida.

This case involves minimum contacts for state tax purposes, which also is a due process requirement. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978). Although it involves state tax rather than adjudicatory jurisdiction, the two situations require "comparable reasoning." *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992). Thus, the North Carolina Supreme Court correctly held below that the domicile of the trust beneficiaries did not create minimum contacts to make the trustee liable for taxes.

Moreover, the trust beneficiaries here did not have a vested interest in trust corpus or income. Even if the state contacts of a vested beneficiary might *sometimes* justify imposing a tax-paying duty on the trustee, the speculative interest of a contingent beneficiary should not be sufficient.

Due process also requires that the income taxed by North Carolina be rationally related to the values connected with the state. *Moorman*, 437 U.S. at 273. Taxing a person as a resident, on all worldwide income, requires substantial contacts with the state, such as domicile, but the taxpayer trustee here had no contacts with North Carolina.

Petitioner's argument that the decision below results in a "judicially created tax shelter" assumes that North Carolina has no choice but to tax trust income to the trustee. That is not correct. Even under current state law, North Carolina can tax trust income to a grantor if the federal grantor trust rules apply, and it can tax trust income to a beneficiary who has certain powers over trust corpus or income. See sections 671-678 of the Internal Revenue Code of 1986, as amended ("I.R.C."), which are incorporated into North Carolina law.

Moreover, North Carolina could follow the lead of some other states and amend its laws to provide for a "throwback rule" under which a resident trust beneficiary would be taxed on any accumulated trust income that has escaped taxation when the income is received by the beneficiary. That is how the federal government taxes accumulated income received by United States beneficiaries from foreign trusts. I.R.C. §§ 665-668.

ARGUMENT

I. Introduction.

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

The trust in this case (the "Trust") had no North Carolina source income. However, Petitioner claims that the Trust can be taxed on all of its income as if it were a North Carolina resident.

The Trust's only contact with North Carolina was that the current beneficiaries (the grantor's daughter and her children), were residents of North Carolina during the tax years at issue. They were contingent beneficiaries because the trustee had the discretion to make, or not to make, distributions to them. The grantor was a New York resident who created the trust in New York. The trustee during the years at issue lived in Connecticut. The trust assets were financial investments whose custodian was in Massachusetts.

North Carolina law imposes a tax on the income of a trust "for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2 (2017). The trust (which is not a legal entity) is not itself liable for the tax. Neither the beneficiary nor the grantor are liable for the tax.

The statute imposes liability for the tax on the trustee. *Id*.

The Due Process Clause places two restrictions on a state's power to tax income. First, a state may not tax income unless it has some minimum connection with the taxpayer and its income-generating activity. This is sometimes called the "nexus" requirement. Second, even where a minimum connection exists, the State may tax only so much of the income as is rationally related to "values connected with the taxing State." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978); see also *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992); and *Mobil Oil Corp. v. Comm'r of Taxes of Vt*., 445 U.S. 425, 436-437 (1980). If a tax fails to comply with either of these restrictions, it violates due process.

II. The Trust Does Not Have Minimum Contacts (Nexus) with North Carolina.

A. The Relevant Minimum Contacts Are Those Between the Trustee and North Carolina.

Due process does not allow a state to tax a person *at all* unless the person has a minimum connection (nexus) with the state. *Moorman*, 437 U.S. at 272-273. But who is the relevant person in the case of a trust? The trust itself cannot be the relevant person because a trust is not "a distinct legal entity, but a 'fiduciary relationship' between multiple people." *Americold Realty Tr. v. Conagra Foods, Inc*., 136 S.Ct. 1012, 1016 (2016).

Amici trust law professors point out that the "abstract nature of a trust has notable consequences": (1) a lawsuit must be brought against the trustee, not the trust;[2] (2) a trustee can own legal title to property but a trust cannot; and (3) a trustee can enter into contracts but a trust cannot. Brief of Amicus Curiae Law Professors in Support of Petitioner, at 14-15. In short, a trust acts through its trustee.

Although legally not an entity, a trust is treated as a "person" for federal income tax purposes:

> [A] trust is an abstraction. . . . Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return *under the hand of the fiduciary* and claiming and receiving its own appropriate deductions.

Anderson v. Wilson, 289 U.S. 20, 27 (1933) (emphasis added); accord *Greenough v. Tax Assessors*, 331 U.S. 486, 493-494 (1947). The duty to file a trust federal income tax return and to pay federal income taxes does not fall on the grantor or any beneficiary; those duties fall on the trustee. See I.R.C. § 6903(a).

North Carolina law similarly treats a trust as an entity for state income tax purposes—and because a trust is not *actually* an entity, North Carolina similarly imposes the obligation to file an income tax return

---

[2] See also *Americold*: "[A trust] relationship was not a thing that could be haled into court; legal proceedings involving a trust were brought by or against the trustees in their own name." 136 S.Ct. at 2016.

upon the fiduciary of a trust (i.e., the trustee). N.C. Gen. Stat. § 105-160.5. North Carolina also makes the "fiduciary responsible for administering the . . . trust" liable to pay the state income tax. N.C. Gen. Stat. § 105-160.2.

Petitioner acknowledges that a trust is "just an abstraction that describes a fiduciary relationship," but then draws the mistaken conclusion that, for due process purposes, minimum contacts can be provided by *any* of "the trust's constituents—the grantor, the trustee, and the beneficiary." Pet. Br. at 16. This Court, when faced with a similar argument in an adjudicatory jurisdiction case, described it as a "non-sequitur." *Hanson v. Denckla*, 357 U.S. 235, 254 (1958).

In *Hanson*, an inter vivos trust was created by a grantor who was domiciled in Pennsylvania. The trust agreement was executed in Delaware. The grantor appointed a Delaware corporate trustee, Wilmington Trust. The grantor later became a Florida resident and remained a Florida resident until her death. While in Florida, she executed a will and also an inter vivos power of appointment under the trust in favor of the children of one of her daughters, who were Florida residents. Her other daughters, also Florida residents, were residuary legatees under her will. The residuary legatees challenged the validity of the trust power of appointment in a Florida court, and obtained a judgment that the trust was invalid, that the power of appointment was not effective, and that all the property passed under the residuary clause of the will. But a Delaware court, in competing litigation, upheld the trust and power of appointment, and also held that the Florida ruling was not binding because Florida lacked personal jurisdiction over the trustee.

This Court considered the jurisdiction issue by applying the "flexible standard" of *International Shoe v. Washington*, 326 U.S. 310 (1945) which, it observed, jettisoned the "rigid rule" of *Pennoyer v. Neff*, 95 U.S. 714 (1878). *Hanson*, 357 U.S. at 251. The "minimal contacts" limitation on personal jurisdiction, the Court said, is "a consequence of territorial limitations on the power of the respective States." *Id*. The Court noted that "it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Id*. at 253. Under Florida law, in order to enter a judgment affecting the validity of a trust, the trustee was "an indispensable party over whom the court must acquire jurisdiction." *Id*. at 254. The Court held that the trustee did not have minimum contacts with Florida:

> We fail to find such contacts in the circumstances of this case. The defendant trust company has no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State either in person or by mail. . . . The cause of action in this case is not one that arises out of an act done or transaction consummated in the forum State.

Id. at 251. The Court considered and rejected the claim that there was jurisdiction because the grantor (settlor) and the beneficiaries were domiciled in Florida:

> It is urged that because the settlor and most of the appointees and beneficiaries were domiciled in Florida the courts of that State should be able to exercise personal jurisdiction over the nonresident trustees. This is a non sequitur. . . . [Florida] does not acquire that jurisdiction by being the "center of gravity" of the controversy, or the most convenient location for litigation. The issue is personal jurisdiction, not choice of law. It is resolved in this case by considering the acts of the trustee. As we have indicated, they are insufficient to sustain the jurisdiction.

Id. at 254.

Here Petitioner argues, by analogy to adjudicatory jurisdiction cases, that a "fairness-based analysis has replaced the rigid, presence-focused analysis that prevailed in the years after *Pennoyer*." Pet. Br. 20. Petitioner argues that *Greenough*, decided two years after *International Shoe*, reflects the shift away from *Pennoyer*. Pet. Br. 27.[3] Of course, *Hanson* explicitly

[3] *Greenough* held that the state in which a trustee is domiciled may impose a property tax on the trust's intangible property. 331 U.S. at 488, 498. Petitioner badly misreads the case as holding that a state can impose a tax on trust income if *any trust constituent* (the grantor, the trustee, or the beneficiary) resides in the state, even though only the trustee resided in the state in *Greenough*. Pet. Br. 16, 26-31. In fact, it was critical to the decision that "the intangibles [were] subject to [the trustee's] immediate control" and that the trustee enjoyed the benefits and protections of

followed *International Shoe* and rejected *Pennoyer*. But Petitioner claims that it is distinguishable because it involved "adjudicative jurisdiction over a *trustee*, not tax jurisdiction over a trust." Pet. Br. 24.

Petitioner's argument fails. This case does not involve tax jurisdiction *over a trust*, because a trust is not a taxable entity. North Carolina law imposes the obligation to file tax returns and to pay tax on the trustee, not the trust. N.C. Gen. Stat. § 105-160.2 and 105-160.5. The *Kaestner* trustee (Mr. David Bernstein) is indispensable to the liability to pay tax, just as the trustee in *Hanson* was indispensable to litigation concerning the trust.

---

the taxing state. 331 U.S. at 493, 496. By contrast, in *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83 (1929), the Court held that the state where the beneficiaries and the grantor resided could not tax intangibles where the trustee was located in another state, and he controlled the trust assets. See also *Brooke v. City of Norfolk*, 277 U.S. 27, 27-28 (1928) (city where beneficiary resided could not tax trust corpus because "the property is not within the State, does not belong to the [beneficiary] and is not within her possession or control."). Contrary to Petitioner's claim, *Greenough* and *Safe Deposit* are consistent: Both held that the trust property could be taxed where it was held and controlled by the trustee. Cf. Pet. Br. 27-28. Petitioner also incorrectly states that *Safe Deposit* is not good law because it was premised on the view that due process prohibits double taxation. Pet. Br. 28, n. 12. Although the Court mentioned double taxation, its holding was based firmly on the rule that due process prevents a state from taxing things "wholly beyond her jurisdiction or control." 280 U.S. at 92. Moreover, Justice Stone's concurring opinion (joined by Justice Brandeis) made it clear that the "threat of double taxation" was not controlling. *Id*. at 95-96.

This Court has held that the state tax nexus requirement is closely related to the due process standard for adjudicatory jurisdiction. *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992). In *Quill*, the Court traced the development of the purposeful availment standard from *International Shoe* through later cases, and then said that "comparable reasoning" would apply in a sales tax case. *Id*. at 307-308. In a concurring opinion, Justice Scalia (joined by Justices Kennedy and Thomas) agreed that the Court's holding was "compelled by reasoning 'comparable' to that contained in our post-1967 cases dealing with state jurisdiction to adjudicate." *Id*. at 320. Although *Quill* involved sales tax collection, Justice Scalia noted that the Court's precedents rejected a distinction "between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State." *Id*.

The purposeful availment test applies here, so the question is whether Mr. Bernstein, the trustee, purposefully availed himself "of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Hanson*, 357 U.S. at 253. Like the trustee in *Hanson*, Mr. Bernstein had no office in the state (North Carolina), transacted no business there, and solicited no business there. None of the trust assets has ever been held or administered in North Carolina. Citing *Hanson* and other adjudicatory jurisdiction cases, the North Carolina Supreme Court correctly held that there was no jurisdiction to tax the trustee on the trust income. Pet. App. 13a. The court did not count benefits that North

Carolina provided to the resident beneficiaries, since they are separate legal persons. That outcome follows naturally from *Hanson*—where the residency of trust beneficiaries did not create jurisdiction over the trustee.[4]

Amici tax law professors claim that the Trust—by which they presumably mean Mr. Bernstein—purposefully availed itself (himself) of North Carolina benefits because it (he) directed activities toward the beneficiaries. Brief of Tax Law Professors as Amici Curiae in Support of Petitioner, at 5 (hereinafter, "Tax Prof. Br."). However, the efforts of the trustee in *Hanson* were also aimed at the beneficiaries, who were domiciled in Florida, yet that did not give Florida jurisdiction. The tax law professors compare Mr. Bernstein's activities (directed to North Carolina beneficiaries) to those of the catalog retailer in *Quill*, which had a due process nexus because it directed marketing efforts to North Dakota customers. *Id*. That is a false analogy. Serving as a fiduciary to residents of the state is not comparable to trying to exploit a commercial market in that

[4] *Hanson* is a foundational case that has been often cited by this Court in its due process decisions. *Hanson* establishes that jurisdiction must arise out of the person's own contacts and not those of a third party. That principal was reaffirmed recently in *Walden v. Fiore*, 571 U.S. 277 (2014). The Court there described *Hanson* as follows: "We have . . . rejected a plaintiff's argument that a Florida court could exercise personal jurisdiction over a trustee in Delaware based solely on the contacts of the trust's settlor, who was domiciled in Florida and had executed powers of appointment there." *Id*. at 284.

state. There is no evidence that Mr. Bernstein did the latter.[5]

B. Even If Minimum Contacts Could Be Established by a Resident Beneficiary, the Beneficiary Would Have to Be Vested, Not Contingent.

North Carolina's statute does not distinguish between vested and contingent beneficiaries. A vested beneficiary is one who, by the terms of the trust, is entitled to receive in a given year all or a portion of the trust's income or prinicipal. Contingent beneficiaries are those who *may* receive trust income or principal, depending on future events or the discretion of the trustee.

Mrs. Kaestner and her three children were contingent *current* beneficiaries during the tax years at issue because they were not entitled to receive any distributions. Distributions were discretionary with the trustee, Mr. Bernstein, who made no distributions.

There were also contingent *remainder* beneficiaries of the Trust, none of whom resided in North Carolina. Jt. App. 11, 39, 52. Those beneficiaries might receive

---

[5] The tax law professors' argument proves too much. If the presence of a trust beneficiary in a state creates nexus to tax a trust's income, by analogy the presence of a corporate shareholder in a state would create nexus to tax the corporation's income, even if the corporation had no other contacts with the state. No state has understood its taxing powers to be so expansive.

trust assets if, for example, the contingent current beneficiaries passed away without surviving issue.

North Carolina seems to have ignored the contingent remainder beneficiaries and treated all of the Trust's income as taxable by the state because the contingent current beneficiaries resided in North Carolina. However, a state might tax a trust as a resident based on the in-state residence of a contingent remainder beneficiary. That is not hypothetical.

The *Fielding* case from Minnesota, to which amicus is a party, involves four siblings. Each sibling is the contingent current beneficiary of one trust, and a contingent remainder beneficiary for the three others siblings' trusts. Only one of the siblings was a Minnesota resident; the other three lived in New York and California. But, because those three trusts have a single Minnesota contingent remainder beneficiary, the Minnesota Commissioner of Revenue takes the position that Minnesota can tax them as Minnesota residents on 100 percent of their income.

If the states where the other siblings resided were also to adopt such a rule, each state would tax all four trusts as residents. Multiple taxation would result, which would be impermissible under the Commerce Clause. See *Comptroller of Treasury of Md. v. Wynne*, 135 S.Ct. 1787, 1802-1803 (2015).[6] Amici tax professors

[6] Petitioner cites *Curry v. McCanless*, 307 U.S. 357 (1939), for the proposition that the Due Process Clause is not concerned with double taxation. Pet. Br. 28, n. 12. In *Curry*, this Court upheld *both* a Tennessee transfer tax upon the death of a state

assure the Court that multiple taxation is not a problem because states allow their residents credits for taxes paid to other states, and they cite to the North Carolina credit statute. Tax Prof. Br. at 27, citing N.C. Gen. Stat. § 105-160.4. However, the North Carolina credit is typical in that it applies only to taxes imposed on income derived from *sources* in another state. *Id*. The Trust had investment income, which is generally deemed not to have a source within another state. States generally "will deny a resident a credit for taxes paid to other states on investment income derived from intangibles." Hellerstein, Hellerstein & Swain, *State Taxation* (3rd ed. 2001, updated December 2018) ¶ 20.09[2][b].[7]

For this reason, and because the interest of a contingent remainder beneficiary may be highly speculative, if (notwithstanding *Hanson*) the Court holds that the presence of a beneficiary satisfies minimum

---

resident who exercised a general power of appointment over intangible property held by a trustee in Alabama, *and* an Alabama inheritance tax on the transfer of that same trust-held property, where the decedent's will was probated in both states. Thus, *Curry* involved death transfer taxes. This Court has never addressed whether double taxation of *income* is permissible under due process. Regardless, even the *threat* of double taxation of income is a problem under the Commerce Clause. See *Wynne*, *supra*.

[7] There was actual double taxation of one of the trusts in the *Fielding* case by California and Minnesota. Minnesota's credit was unavailable for taxes paid to California on investment income.

contacts, it should not extend that holding to include contingent remainder beneficiaries.

Indeed, because the interest of a contingent current beneficiary in trust income is also speculative, the Court should hold that the current beneficiaries' residence in North Carolina does not satisfy the minimum contacts test. Those beneficiaries had no right to any trust income during the tax years in question, and they might never receive all (or even any) of the accumulated trust income.

III. North Carolina Seeks to Tax 100 Percent of the Trust's Income, Which Is Not Rationally Related to "Values Connected with the Taxing State."

Even when there is a minimum connection between the taxpayer and a state, the state may tax only so much of the taxpayer's income as is rationally related to "values connected with the taxing State." *Moorman*, 437 U.S. at 272-273; *Quill*, 504 U.S. at 306.

When a state seeks to tax 100 percent of a person's worldwide income by treating him as a resident, the required connection to the state must be substantial. Domicile (where a person makes his home) traditionally provides the basis for taxing an individual as a resident because "[e]njoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government." *Lawrence*, 286 U.S. at 278. Some states treat a non-domiciled individual as a resident if the individual spends more than one-half the year physically present in, and has an abode in, the state. See, e.g., Minn. Stat. § 290.01, subd. 7(b) (2018); N.Y. Tax Law § 605(b)(1)(B) (2018). There too, the connection is substantial—state protections and services are provided for most of the year.

In this case, North Carolina would tax the trustee (Mr. Bernstein) on 100 percent of the trust's income, even though the only contact with the state is that of third parties, the trust beneficiaries. Petitioner asserts that the state provides legal benefits and protections to the beneficiaries. Pet. Br. 17. That might allow North Carolina to tax *the beneficiaries*. However, the tax here is imposed on Mr. Bernstein, who has no contacts with North Carolina.

Moreover, even if it were correct to consider state benefits provided to a beneficiary as establishing a rational relationship to trust income, in this case the beneficiaries residing in North Carolina had no vested interest in trust income or corpus. Distributions to them during the tax years at issue were solely within the discretion of Mr. Bernstein, who made no distributions.[8]

[8] Amici tax law professors assert that state benefits provided to the beneficiaries, such as schooling, also benefited the Trust, which would otherwise have to make distributions to pay for schooling. Tax Prof. Br. 12-15. However, that is just a roundabout way of saying that, because of public schools, distributions could be made to the beneficiaries for other purposes—the beneficiaries might benefit, not the Trust or the trustee. Thus, amici are

IV. By Following Federal Models for the Taxation of Grantors and Beneficiaries, North Carolina Can Prevent Tax Sheltering.

Petitioner asserts that if the Court affirms the North Carolina Supreme Court, a so-called "judicially created tax shelter" will exist because states will be limited to taxing intangible trust investment income (not having a source within the state) based on the domicile of the trustee (or other place of trust administration), and the trustee can be located in a no-tax state. Pet. Br. 40.

That does not help Petitioner, for several reasons. First, there is no "avoiding tax shelters" exception to the Due Process Clause. Due process precludes taxing a trustee on trust income based on state contacts with third parties, such as the beneficiary or the grantor. State revenue consequences are simply irrelevant to that analysis. Second, states are not limited to taxing trust income to just the trustee. Most states (including North Carolina) already incorporate provisions of the Internal Revenue Code that tax trust income to a

---

improperly using contingent beneficiary contacts to establish jurisdiction whereas the relevant contacts are those of the trustee. *Cf. Kulko v. Superior Court*, 436 U.S. 84, 94 (1978) (state services provided to daughter did not create jurisdiction over nonresident father, even though he had a support obligation). Amici also claim that North Carolina provides a forum for litigation, Tax Prof. Br. 13-14, but *Hanson* establishes that there would be no jurisdiction in North Carolina to litigate trust issues. Of course, a trustee might litigate other disputes (such as commercial disputes) in the various states where they arise. However, that does not mean that every state has the requisite rational relationship to tax *all* of the Trust's worldwide income.

resident grantor or beneficiary in appropriate situations. Third, states can tax a resident beneficiary on previously-untaxed accumulated trust income when the income is distributed to the beneficiary. Some states have already taken this approach.[9]

For the taxable years at issue, North Carolina defined state taxable income as federal taxable income, with certain modifications. N.C. Gen. Stat. § 105-134.5. North Carolina therefore adopted the federal grantor trust rules. I.R.C. §§ 671-677. These rules tax trust income to the grantor in cases where the grantor retains certain reversionary interests in corpus or income, retains the power to control beneficial enjoyment of corpus or income, retains certain administrative powers over the trust, retains the power to revoke the trust, or retains the right to receive income without the approval of an adverse party. Thus, a North Carolina resident cannot simply form a grantor trust with a trustee in a nontax state and expect to escape North Carolina tax.

Similarly, North Carolina incorporates I.R.C. § 678. Under that section, if a trust beneficiary has a power exercisable solely by herself to vest the corpus or the income in herself, the beneficiary is treated as

[9] Under Subchapter J of the Internal Revenue Code, which states generally follow, beneficiaries are taxed on distributions of net income earned during the taxable year. Petitioner's concern is with the taxation of income *accumulated* by a trust, which is taxed to the trustee. If such income is not taxed to the trustee, it might be taxed to the beneficiary when a distribution is received, as discussed below.

the owner and is taxed currently on the trust's income whether or not the income is actually distributed. This is a substance-over-form provision, but it did not apply to the beneficiaries here during the years at issue because they had no right to demand distributions.

To be sure, North Carolina could not use I.R.C. § 678 to tax a *contingent* beneficiary on undistributed trust income, but that is appropriate. The exercise of dominion over income is a requirement for a person to be taxed on the income. *First Sec. Bank of Utah v. Comm'r*, 405 U.S. 397, 403 (1972) ("[I]n order to be taxed for income, a taxpayer must have complete dominion over it."); see also *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955); *Comm'r v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209-210 (1990); and *Comm'r v. Banks*, 543 U.S. 426, 434-435 (2005).

But North Carolina easily could tax trust income that is actually distributed to contingent beneficiaries domiciled in the State. To do so, it could adopt rules similar to the federal throwback rules of I.R.C. §§ 665-668. For the federal government, these rules prevent revenue loss when a foreign trust is established for the benefit of a United States beneficiary. To the extent that the income of the foreign trust is not currently taxed, when the beneficiary receives a distribution he must pay a throwback tax, which is computed by "throwing" the income back to the tax years of the beneficiary that correspond to the years when the trust earned the income. A credit is allowed for any tax paid by the trustee on the income.

Some states have already adopted state throwback rules to tax resident beneficiaries on distributions from nonresident trusts. See, e.g., Cal. Rev. & Tax Code § 17745(b); 61 Pa. Code § 105.5(c); N.Y. Tax Law § 612(b)(40).[10] North Carolina could adopt similar legislation to prevent future revenue losses.

Petitioner points out that a beneficiary might move out of the state before receiving a distribution. Pet. Br. 40. But *bona fide* relocations simply are not tax avoidance. Petitioner's hypothetical is similar to a situation where a person owning appreciated stock moves to another state before selling it, or gives the stock to a child domiciled in another state. These situations are generally not regarded as involving tax avoidance because changing domicile, or gifting stock, have material non-tax consequences. To be sure, some beneficiaries may attempt tax avoidance through sham relocations, but states have ample authority to prevent such schemes. For example, California addresses the problem by statute:

> In the event that a person is a resident beneficiary during the period of accumulation, and leaves this state within 12 months prior to the date of distribution of accumulated income and returns to the state within 12 months after distribution, it shall be presumed that the beneficiary continued to be a resident of this state throughout the time of distribution.

---

[10] In *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), the court upheld California's throwback tax on a resident beneficiary who received distributions of untaxed trust income.

Cal. Rev. & Tax Code § 17745(e). North Carolina could adopt a similar rule. In appropriate cases, judicial anti-abuse doctrines might also apply.

CONCLUSION

The judgment of the North Carolina Supreme Court should be affirmed.

Respectfully submitted,

WALTER A. PICKHARDT
Counsel of Record
LAURA S. CARLSON
CAITLIN E. ABRAM
NICHOLAS J. NELSON
FAEGRE BAKER DANIELS LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-7000
walter.pickhardt@faegrebd.com

Counsel for Amicus Curiae

March 22, 2019