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**

**BRIEF FOR *AMICI CURIAE*
WASHINGTON STATE TAX PRACTITIONERS
IN SUPPORT OF RESPONDENT**

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March 25, 2019

QUESTION PRESENTED

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

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BRIEF OF *AMICI CURIAE*
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INTEREST OF THE *AMICI CURIAE*

Amici curiae ("Practitioners")[1] are lawyers practicing state and local tax law and trust and estates law in Washington State. Practitioners regularly apply this Court's Due Process Clause and Commerce Clause precedents in the representation of U.S. and foreign individuals, families, charities, and business organizations of every kind. Others are regularly engaged in advising clients about their options in the structuring of trusts and related tax consequences at the state and federal levels.

Practitioners join this brief solely as individuals and not as representatives of the law firms or associations with which they are affiliated. Each Practitioner is currently in private practice. Among them are Practitioners who are Fellows of the American College of Trust and Estate Counsel; who have taught state and local taxation or estate planning at the University of Washington School of Law; who have served in the past as President or Treasurer of the Washington State Bar Association; or

[1] No counsel for a party authored this brief in whole or in part, nor made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amici curiae* or its counsel made a monetary contribution to its preparation or submission. Petitioner and Respondents have filed Blanket Consents to the filing of *amicus curiae* briefs with the Clerk of the Court.

who have served in the past as chair of the Association's Real Property, Probate and Trust Section, Taxation Section, or State and Local Taxes Committee. Their experience is not limited to representing taxpayers, some having worked in the past for the Washington State Department of Revenue as a former Assistant Director for Interpretation and Appeals, a second former appeals officer, and a legislative affairs officer. A full list of *amici* appears in Appendix A.

The Petitioner frames the Question Presented as whether due process restricts the power of states to "tax[ ] trusts." The question as posed is not inherently limited to income taxation. Practitioners hope that, informed by experience that cuts across the multiple forms of state taxes, their views may assist the Court in this case.

SUMMARY OF ARGUMENT

1. The Petitioner's argument boils down to two points. First, the Petitioner asserts it is fair to tax a trust based solely on the in-state residence of a beneficiary because of the "inseparable relationship" between a beneficiary and the trust. Pet. Br. at 36. "[W]hen a trust beneficiary lives in a state, so does her trust." *Id.* at 34.

Second, the Petitioner asserts that it would be unfair *not* to tax the trust because otherwise the beneficiary would be a "free rider" on the publicly funded services of North Carolina government. "North Carolina gave Ms. Kaestner the opportunity to send her children to the state's excellent public schools at no charge." *Id.* at 35. "North Carolina shouldered [the] responsibility [to provide for the beneficiaries' health and welfare] by giving Ms. Kaestner and her children all of the critical public-safety services needed to protect their health and welfare." *Id.* Unless the state is allowed to tax the trust's income, "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." *Id.* at 40.

Practitioners believe the Petitioner has it wrong on both counts. As to the first point, the Petitioner urges this Court to adopt a legal "formalism" – a one-to-one equivalency of trust and beneficiary for jurisdiction purposes – of exactly the kind that the Petitioner otherwise urges the Court to reject. The facts of this case, and other examples in Practitioners' experience, show by contrast that trusts are idiosyncratic. They can be imbued with values and purposes other than, and more complex than, the current welfare of the current beneficiary. To adopt the Petitioner's blanket rule, "the trust always resides in the same state as the beneficiary," would itself be arbitrary and capricious.

As to the second point, the insinuation that Ms. Kaestner has enjoyed North Carolina public services "on a tax-free basis" is unfair and contrary to the record. From all that appears, Ms. Kaestner's family has made more than ample contributions to the state's fisc and the welfare of the community.

2. The record shows that the trustee in this case has made no meaningful efforts, either in generating income or managing assets, to "purposefully direct" his activities to North Carolina

or to "purposefully avail" himself of the benefits that the state government affords. Practitioners fully support the Respondent's position that these formulations express the "irreducible due process requirement" for state jurisdiction over a nonresident, whether for tax or other purposes. Resp. Br. at 34; *see id.* at 33-35.

However, if the Court is inclined to entertain the Petitioner's claim that it is fair to assess tax liability against a trust based on its inherent relationship with beneficiaries, the Court should recognize that the quality of that relationship varies according to the powers and privileges the beneficiary enjoys internal to the trust. This Court's precedents concerning when trust assets may be included in a beneficiary's taxable estate upon death provide a ready analogy for determining when a beneficiary is sufficiently in control of the trust to identify the trust with her for tax purposes.

In *Curry v. McCanless*, 305 U.S. 347 (1939), the Court famously held that the Due Process Clause does not prohibit taxing trust assets twice, under two states' transfer taxes, if the power to tax is otherwise present. More importantly for the present case, the Court said why each state had the power to include trust assets in the taxable estate. Tennessee, the deceased trust beneficiary's state of residence, could include the assets in the taxable estate because the beneficiary held a general power of appointment, which the Court treated as tantamount to full ownership of the assets. *Id.* at 371-72. Alabama, where the trustee held the assets in question, could impose its transfer tax because of the control over the assets held by the trustee. *Id.* at 370. In each state, a resident held a power or privilege to which the transfer tax could obtain. *See also Whitney v. State Tax Comm'n of New York*, 309 U.S. 530, 538 (1940) (beneficiary's privilege of determining property succession is the taxable privilege).

This Court moreover found it could make no distinction between jurisdiction to impose a direct tax on property and jurisdiction to impose an indirect tax on the same property. Thus the fact that Alabama could impose a property tax on trust assets legally owned by the trustee justified including those assets in the measure of Alabama's inheritance tax. *Curry*, 305 U.S. at 370.

The converse principle is aligned with and supports continued application of this Court's decisions in the direct-tax cases. If the beneficiary does not hold sufficient power, privilege, or control with respect to trust assets to subject the trust assets to tax upon her death, then her state of residence has no claim to tax undistributed trust income held by a remote trustee merely because of in-state residence. If the beneficiary and trustee know that, under privilege-tax analysis, trust assets could not be included in the beneficiary's estate upon death, how could they have had fair notice that undistributed income would be taxable in the beneficiary's state of residence during her life?

ARGUMENT

I. The Petitioner's "Fairness" Arguments Are Formalistic and Arbitrary; Trusts Are Not Uniform and Beneficiaries Cannot Be Presumed to Consume State Resources Without Making Their Own Tax Contributions.

A. The Petitioner's proposed rule – "Where the beneficiary resides, so does her trust" – arbitrarily ignores the flexibility of the trust structure and the diversity of values and purposes embodied in them.

The Petitioner argues that the beneficiary is the central constituent of the trust relationship and asserts that a trust "exists solely 'for the benefit of its beneficiaries.'" Pet. Br. at 29 (quoting Unif. Trust Code § 40 (Unif. Law Comm'n 2000)). This "inseparable relationship" between beneficiary and trust supplies the "minimum connection" between the remote trustee and the beneficiary's state of residence. *Id.* at 36. The proposed rule of decision is, "when a trust beneficiary lives in a state, so does her trust." *Id.* at 34.

The Petitioner paints a grossly static and uniform portrait of trusts in the United States. The Brief *Amicus Curiae* for the American College of Trust and Estate Counsel ("ACTEC Brief"), pages 7 to 9, by contrast, enumerates the variety of forms of shared beneficial interests accommodated by the trust structure. It is obvious that not all beneficiaries are equal. Beneficiaries have diverse claims upon trust assets and income.

Two examples from Practitioners' own clientele illustrate how the trust can embody values and purposes that are not captured by the rote recitation that a trust exists solely for the benefit of its beneficiaries. The first example represents one family's solution to the excruciating problem of a child's drug addiction. During their lives, the parents intended to assist their son in becoming stable and sober directly, but in the event of death they established a testamentary trust that reflected a "tough love"/no-waste perspective. As beneficiary, the son would become eligible for income distributions if he proved he was "clean" through a number of repeated, random drug tests, and would remain eligible only if he again tested "clean" when called for testing. The trust provisions of the will provided that, if he was not "clean" as of a certain age, his status as beneficiary would terminate, and the contingent remainder beneficiaries (his children, if any, or his nieces and nephews) would then become current beneficiaries. In a real sense, this trust was designed to avoid creating a unity of interest between trust and beneficiary, and instead potentially to prefer remote beneficiaries. Even if the trustee could be said to be purposefully availing itself of a state's civilized society where the drug testing might occur (should the son submit to it), this would not necessarily have been the state of the beneficiary's residence. The Petitioner's one-size-fits-all formula does not reasonably apply to this trust.

A more common situation involves second marriages. When a person has children in a first marriage and then remarries, the motivation is frequently to preserve assets for the children rather than expend them for the surviving second spouse. Thus the trust might entail provisions allowing the trustee to distribute income to the surviving second spouse as beneficiary if necessary or desirable for the survivor's comfort, but to deny the survivor any power of appointment and to guarantee eventual distribution of trust corpus to the children of the first marriage. This structure has in fact been used by clients in Practitioners' experience. It makes no sense to say that, where the surviving spouse resides, so does the trust. The remainder beneficiaries have greater weight in the trust relationships in this situation. The surviving spouse's movements around the country or internationally cannot fairly trigger tax jurisdiction over trust income or property automatically wherever he or she lands.

The facts of the present case also reveal dynamics that disprove the reasonableness of the Petitioner's proposed rule of decision. The trustee had unfettered discretion to reallocate beneficial interests completely among an extended family of beneficiaries, even to exclude individual beneficiaries from distributions. *See* App. 50. The trustee never disclosed the existence of the Trust to Ms. Kaestner, and she learned about it only when her father informed her 15 years after the Trust's creation. App. 84. How could the Trust reside where Ms. Kaestner resided when it was kept a secret from her?

The Petitioner's rule of decision arbitrarily disregards the multiform dynamics that families choose to embody in the trust structure. It would be a formalistic rule *par excellence*. The Petitioner rightly reminds the Court on its history of avoiding formalism, *e.g.*, Pet. Br. at 2, but itself falls into a formalistic trap. The due process rule must take into account the specific circumstances of the trust and beneficiaries in question. *See Rush v. Savchuk*, 444 U.S. 320, 332 (1980) ("The requirements of *International Shoe*,[2] however, must be met as to each defendant over whom a state court exercises jurisdiction."), *quoted in Walden v. Fiore*, 571 U.S. 277, 286 (2014).

B. The Court should not allow false insinuations that the Beneficiary is a "free rider" on public resources to influence constitutional analysis.

The Petitioner's Brief is laced throughout with insinuations that the Beneficiary would get something for nothing if the decision below were not reversed. "North Carolina offered [Ms. Kaestner and her children] 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." Pet. Br. at 17. If "beneficiaries like Ms. Kaestner" could select out-of-state trustees in reliance on the decision below, the Petitioner argues, they "could live in their home states, consume state resources, and accept other protections from the state on a *tax-free basis*." *Id.* at 40 (emphasis added).

From all that appears in the record, this is a baseless claim. The Brief of Respondent states that

[2] *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

Ms. Kaestner's family has paid North Carolina tax on the income they received and controlled. Resp. Br. at 45. This Court can also presume that, contrary to the Petitioner's insinuation, Ms. Kaestner's family supported North Carolina's state and local governments through the other tax regimes maintained there – property tax, sales tax, and other excise taxes. *See*, *e.g.*, N.C. Gen. Stat. §§ 105-271 *et seq*. (property tax), 105-164.4 *et seq*. (sales and use taxes), 105-187.1 *et seq*. (highway use (motor vehicle) tax); *see generally* N.C. Gen. Stat. ch. 105 (taxation). These contributions follow from the family's situation, as the trustee in this case testified: "They were not looking for distributions of income from the Trust. Indeed Ms. Kaestner's husband is quite a successful businessman." App. 105.

Moreover, the family's contributions to North Carolina's well-being are not limited to taxation. The record shows "[t]hey are very active [in] Durham Cares," App. 104, a faith-based, multi-ethnic community building organization in their home city of Durham. *See* https://www.durhamcares.org/.

The Petitioner's implicit disparagement of Ms. Kaestner as a free rider is an unfortunate tactic. It stains the Petitioner's pose of seeking what it alleges is "only fair." Pet. Br. at 17. This Court should not rely on the Petitioner's reckless and arbitrary imputation in weighing the constitutional values presented by this case.

As residents of Washington State, Practitioners also know personally that there is no necessary or constitutional linkage between paying an income tax and making fair contributions to the functions of government. Washington has no personal or corporate income tax. Consequently, North Carolina might argue that billions of dollars of income go "untaxed" in this state. But Washington citizens are not free riders; we pay tax according to the tax system arranged by the legislature and the voters at large, *see* Wash. Rev. Code titles 82 (excise taxes) and 84 (property tax), and as constrained by the state and federal constitutions. *See*, *e.g.*, *Mahler v. Tremper*, 243 P.2d 627 (Wash. 1952) (upholding validity of tax on real estate sales as an excise tax); *Harbour Vill. Apartments v. City of Mukilteo*, 989 P.2d 542 (Wash. 1999) (invalidating local tax on rental dwelling units as non-uniform property tax). Constitutional limits on state taxing power do not impugn the character of citizens who do not pay an unlawful tax.

II. If The Court Is Inclined to Accommodate Tax Jurisdiction Based on the Trust-Beneficiary Relationship and Not the Volitional Acts of the Trustee, the Powers and Privileges Enjoyed by the Beneficiary Should Be the Key Consideration.

The contested issue in the case is whether, as the Petitioner argues, the Due Process Clause permits the exercise of tax jurisdiction over a remote trustee simply because of the fiduciary relationship between the trustee and the resident beneficiary or, as the Respondent argues, due process permits tax jurisdiction over the trustee only if the trustee, by his own actions, has purposefully availed himself of the privilege of conducting activities within the taxing state. *Compare* Pet. Br. at 16-17, 29-30, 36, *with* Resp. Br. at 12-13, 23-27, 32-34.

The record shows that the trustee in this case has made no meaningful efforts, either in generating income or managing assets, to "purposefully direct" his activities to North Carolina or to "purposefully avail" himself of the benefits that the state government affords. Indeed, the Petitioner has made no claim that the Trust or the trustee "purposefully availed" himself of the market or civilized society supported by North Carolina, as noted in the Respondent's brief. *See* Resp. Br. at 13. Two *amici curiae* do attempt to elide the differences between the parties, claiming that the trustee had a "purposeful" orientation toward North Carolina, but they do not rely on any volitional choices made by the trustee to obtain benefits provided by North Carolina. Instead, the *amici* simply apply the label "purposeful" to the trustee's connection to North Carolina, though that connection is incidental to the trust structure rather than voluntary. *See* Br. of Tax Law Professors at 8; Br. of Constitutional Law Scholars at 9. Their position is the same as the Petitioner's, but with a different label, and their usage obscures rather than clarifies the issue.

Practitioners fully support the Respondent's position that a remote person's volitional actions oriented toward enjoying the benefits of the taxing or forum state constitute the "irreducible due process requirement" for state jurisdiction over the nonresident, whether for tax or other purposes. Resp. Br. at 33; *see id.* at 32-34. Practitioners also join in the concerns expressed in the ACTEC Brief that adopting the Petitioner's position would threaten disruption of jurisdictional law far beyond income taxation. *See* ACTEC Br. at 32-35. To paraphrase from a personal-jurisdiction decision, "What is needed—and what is missing here—is a connection between [North Carolina] and the [production or enjoyment of the income] at issue." *Bristol-Myers Squibb Co. v. Superior Ct. of California*, 137 S. Ct. 1773, 1781 (2017).

If the Court is inclined, however, to entertain the Petitioner's claim that it is fair to assess tax liability against a trust based on its inherent relationship with beneficiaries, the Court should recognize that the quality of that relationship varies according to the powers and privileges the beneficiary enjoys internal to the trust. The Petitioner asks the Court to adopt a uniform, formalistic, arbitrary picture of the trustee-beneficiary relationship—a picture that does not reflect realities. Due process requires a more individualized template.

The Respondent appropriately points the Court to its precedents concerning when a state may impose a direct tax on trust property or income with reference to the in-state residence of the beneficiary or trustee. Resp. Br. at 16-23 (discussing *Brooke v. City of Norfolk*, 277 U.S. 27 (1928); *Safe Deposit & Trust Co. of Baltimore, Md. v. Commonwealth of Virginia*, 280 U.S. 83 (1929); *Guaranty Trust Co. of New York v. Commonwealth of Virginia*, 305 U.S. 19 (1938); *Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486 (1947)). Whether the in-state beneficiary or trustee has possession, control, or enjoyment of the property or income is the key to these direct-tax decisions. Resp. Br. at 22-23.

To validate the fairness of this standard, the Court may consult its decisions in the analogous area of indirect taxes, specifically estate and transfer taxes. The Court has had several occasions to determine when trust assets may be included in a beneficiary's taxable estate upon death. These decisions provide a ready analogy for assessing whether a beneficiary is sufficiently in control of trust property to identify the trust with her for tax purposes.

The decision in *Curry v. McCanless*, 305 U.S. 347 (1939), is most renowned for the Court's conclusion that the Due Process Clause does not prohibit taxing the value of trust assets twice, under two states' transfer taxes, if the power to tax is otherwise present. *See*, *e.g.*, Pet. Br. at 28 n.12. More importantly for the present case, the Court in *Curry* said *why* each state had the power to include trust assets in the taxable estate. Tennessee was the deceased trust beneficiary's state of residence. The Court said Tennessee could include the trust assets in the taxable estate because the beneficiary held a general power of appointment, which the Court treated as tantamount to full ownership of the assets. *Curry*, 305 U.S. at 371-72. Alabama was where the trustee held the assets in question. The Court said Alabama could impose its transfer tax because of the control over the assets held by the trustee. *Id.* at 370. In each state, a resident held a power or privilege to which the transfer tax could attach.

Indeed, on the Alabama question this Court reasoned by analogy in the way suggested here. Alabama had power to impose a direct tax (a property tax) on the assets held by the trustee in that state. *Id.* (citing *Safe Deposit*). Since this was true, the Court said, "we perceive no ground for saying that the Fourteenth Amendment forbids the state to tax the transfer of it or an interest in it to another . . . ." *Id.*

The converse analysis fully supports the Respondent's position. The estate tax is an excise tax, *see Knowlton v. Moore*, 178 U.S. 41, 47, 81 (1900), that depends on the decedent's transfer of property on death, and the existence or exercise of a privilege with respect to trust property is essential to the inclusion of trust property in a decedent beneficiary's estate. The power to determine the succession and enjoyment of property "is precisely the privilege which the state confers and upon which it seizes for the imposition of a tax." *Whitney v. State Tax Comm'n of New York*, 309 U.S. 530, 538 (1940) (upholding state estate tax on trust corpus where lifetime trust beneficiary exercised power of appointment).

If, however, the beneficiary was not the grantor of the trust and lacks a power, privilege, or control with respect to trust assets, there is no taxable transfer upon death. The federal estate tax captures in the "gross estate" the value of "all property *to the extent of the interest therein of the decedent* at the time of his death." 26 U.S.C. § 2032 (emphasis added). Consistent with this Court's decisions, however, *see Curry*, 305 U.S. at 371, a lifetime beneficiary of a trust created by another person is not deemed to have a taxable interest in trust property unless the beneficiary holds a general power of appointment as defined in 26 U.S.C. § 2041.[3]

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[3] A transfer tax imposed on the receipt of inheritances, on the other hand, may be imposed on the value of trust assets received

If a trust beneficiary lacks sufficient interest in trust property via the terms or operations of the trust to subject the trust assets to transfer tax upon her death, then her state of residence should have no claim to tax undistributed trust income merely because of the in-state residence. From a due-process, fair-notice perspective, if the beneficiary and trustee know under these principles that the beneficiary holds an insufficient interest in trust assets to include them in the beneficiary's estate upon death, they could not have had fair notice that undistributed income owned by a remote trustee would be taxable in the beneficiary's state of residence during her life.

If, therefore, this Court is inclined to weigh the jurisdictional claims of a state to tax the undistributed income of a foreign trust in part based on the in-state residence of a beneficiary, the question whether the beneficiary holds rights and powers internal to the trust sufficient to include trust assets in the beneficiary's taxable estate is aligned with and supports continued application of the Court's precedents involving direct taxation of trust property and income.

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by a remainder beneficiary. *See West v. Oklahoma Tax Comm'n*, 334 U.S. 717 (1948). Such a tax does not rely on the character of the decedent beneficiary's interest in the trust property.

CONCLUSION

For the foregoing reasons, *Amici Curiae* Washington State Tax Practitioners respectfully request that the Court affirm the decision below.

Respectfully submitted,

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APPENDIX

APPENDIX A

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