

Supreme Court Holds North Carolina Trust Taxation Law Is Unconstitutional

On June 21, 2019, the U.S. Supreme Court unanimously held that a state cannot tax trust income solely because the beneficiaries are state residents.

At issue in *North Carolina Dep't of Revenue v. Kimberly Rice Kaestner 1992 Family Trust*¹ (“*Kaestner*”) was North Carolina’s law imposing tax on any trust income that “is for the benefit of” a North Carolina resident.² North Carolina’s Department of Revenue relied on this statute to tax the income of a trust purely because the beneficiaries were residents of North Carolina. No other connections between the trust and North Carolina existed: neither the trustee nor the settlor was a resident of North Carolina; the trust was administered in New York and Massachusetts; and there were no direct investments in North Carolina. Moreover, during the years in question, the beneficiaries received no distributions, had no right to demand trust income or to control trust assets, and had no assurance of ever receiving trust income; the out-of-state trustee had “absolute discretion”³ over the trust, including its termination.

Both the trial court and the North Carolina Supreme Court held that basing the tax solely on the beneficiaries’ residence was too tenuous a link between the State and the trust, thus violating the due process clause of the Fourteenth Amendment. The Supreme Court affirmed. It held that the Due Process Clause requires that the resident beneficiary also “have some degree of possession, control, or enjoyment of the trust property or a right to receive that property before the State can tax the asset.”⁴ If the tax is premised only on the in-state residence of the beneficiary, the State lacks the “minimum connection”⁵ required by the Constitution.

The opinion underscored that the holding was narrow and limited to the specific facts presented in this case.⁶ Writing for the majority, Justice Sotomayor stated that the decision specifically does not address state income tax laws that (i) consider the residency of the beneficiary as just one factor among others, (ii) rely solely on the residency of the settlor or trustee, or (iii) rely solely on the residency of noncontingent beneficiaries. Likewise, in his concurring opinion, Justice Alito made “clear” that the “decision not to answer questions not presented by the facts of this case does not open for reconsideration any points resolved by our prior decisions.”⁷

Kaestner was the Supreme Court’s first opportunity to address a due process claim on state taxation of a non-resident since the Court’s *Wayfair* decision one year ago. However, given its narrow holding, *Kaestner* does not shed light on the constitutional limits of *Wayfair*’s economic nexus test, including how the economic nexus test could be vulnerable to a due process claim.

¹ 588 U.S. __ (2019), No. 18-457, 2019 WL 2552488 (U.S. June 21, 2019).

² *Id.* at *2.

³ *Id.* at *3.

⁴ *Id.* at *6.

⁵ *Id.*

⁶ *Id.* at *9.

⁷ *Id.* at *10 (Alito, J., concurring).