The Supreme Court’s holding in *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust* is narrow, precise, and unanimous. The presence of in-state beneficiaries alone does not allow a state to tax undistributed trust income where the beneficiaries have no right to demand that income and may never receive it.

The Kimberley Rice Kaestner trust is governed by New York law and its trustee is a New York resident who has “absolute discretion” to distribute the trust. When the trustees, Kimberley Rice Kaestner and her children, lived in North Carolina the state taxed the income of the trust even though no funds were distributed during the time period. The trust sued North Carolina seeking the $1.3 million it paid in taxes. The trust argued that the tax violated the Due Process Clause of the Fourteenth Amendment.

The Supreme Court has held that for a state tax to comply with the Due Process Clause there must be some “minimum connection” between the state and the person or property the state seeks to tax.

The Supreme Court agreed with the trust that North Carolina lacked a sufficient minimum connection with the trust, based solely on the beneficiaries in-state residence, to tax its undistributed income. Writing for the Court, Justice Sotomayor noted that “when a tax is premised on the in-state residence of a beneficiary, the Constitution requires that the resident 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.” Here, the beneficiaries received no income from the trust, had no right to demand trust income, and could not necessarily count on receiving funds from the trust in the future.

According to an *amicus brief* filed by Minnesota and twenty other states, the “majority of states (twenty-seven) provide for some form of trust income taxation based on either the location of the beneficiary or the location of the grantor.” These states should determine if their law needs to be modified in light of this case.

By:
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Tags: