# NEWSLETTER

# U.S. Supreme Court Update


**THAT WAS CLOSE! - U.S. SUPREME COURT RULES THAT STATES CANNOT TAX TRUST INCOME SOLELY BASED ON THE RESIDENCE OF BENEFICIARIES.**

*June 21, 2019* - The United States Supreme Court put taxpayer anxiety to rest last Thursday by issuing a unanimous decision against North Carolina's tax law in the recently argued Kaestner case.[1] As noted in our May newsletter, the issue in Kaestner involved whether a state could tax the undistributed income of a trust if the only connection to that state was a beneficiary who resided there.

While the consequences of this case certainly had the potential to expand state taxing authority, the U.S. Supreme Court appeared to temper this authority on constitutional grounds. Citing the Due Process clause of the Constitution, the Court found that in the context of trust beneficiaries, the extent of an in-state beneficiary's right to control, possess, enjoy, or receive trust assets directly influences a state's ability to tax a trust's income.

Simply put, a state cannot tax a trust solely because one of its beneficiaries is a resident. The trust must have some greater connection to the taxing state (such as in-state management of assets or certain beneficiary withdrawal rights) to subject the trust to taxation. For further details about the case, please read on to the next page.

### The Facts

While we described the facts of Kaestner in our prior newsletter, a quick refresher is necessary to understand the Court's analysis.

The Kaestner trust was formed in New York and managed by an out-of-state trustee at all times. The trustee had the sole power to distribute income to any trust beneficiary as he pleased.

One of the trust beneficiaries lived in North Carolina and, on this basis alone, the state tried to tax the trust's undistributed income.

In response, the trust argued that this tax was especially aggressive in light of the fact that the beneficiary had no real power over trust distributions, and never actually received distributions in North Carolina.

### The State's Argument

In an attempt to validate its tax, North Carolina first argued that "a trust and its constituents" are always "inextricably intertwined" and beneficiaries are essential to a trust much like a trustee and a settlor. The State failed to appreciate the various levels of beneficiary interest trusts.

Second, the State argued that an unfavorable ruling would "undermine numerous state taxation regimes".

Finally, the State argued that ruling in the Trust's favor would result in forum shopping, where a beneficiary would forgo taking a distribution until moving to a state with a lower level of taxation. This was determined to be an attempt to conjure the "minimum connection" between the State and the Trust based on mere speculation about negative consequences.

### The Bottom Line

In striking down North Carolina's arguments, the Court held that the presence of beneficiaries in the State alone does not empower the State to tax trust income that has not been distributed when the beneficiaries have no right to demand that income and have no certainty they will receive it.

In so holding, the Court drew a line "between taxation and mere unjustified confiscation."'[2]

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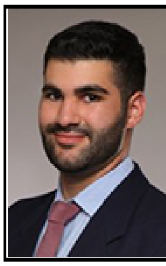

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1. North Carolina Dep't of Rev. v. Kimberley Rice Kaestner 1992 Family Trust, No. 18-457 (U.S.).

[2] Kaestner, No. 18-457 (U.S.) (citing Miller Brothers Co. v. Maryland, 347 U.S. 340, 342 (1954)).