



## *Tax Alert*

### **State Taxation of Trusts: U. S. Supreme Court Favorable Decision**

By Sheppard F. Miers, Jr.  
June 25, 2019

The U. S. Supreme Court [has decided an important case](#) affecting state taxation of trusts and trust beneficiaries.

In the case of *North Carolina Dept. of Revenue v. Kimberly Rice Kaestner 1992 Family Trust*, decided June 21, 2019, the Court held that the presence of in-state beneficiaries alone does not empower a state to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain to receive it.

In the *Kaestner* case North Carolina attempted to impose its tax on income of a trust that was created and administered in New York by a trustee residing in New York. After the trust was created, certain beneficiaries of the trust became residents of North Carolina.

The trust agreement granted the trustee absolute discretion to distribute the trust's assets to the beneficiaries. During the periods involved, the trust beneficiaries residing in North Carolina had no right to demand, and did not receive, any distributions from the trust. Also in those years, the trust did not have a physical presence, make any direct investments, or hold any real property in North Carolina.

Nevertheless, North Carolina attempted to tax income of the trust under its law authorizing the state to tax any trust income that "is for the benefit of" a state resident. It assessed a tax of more than \$1.3 million for tax years 2005 through 2008.

The Court's decision was based on the Due Process Clause of the Fourteenth Amendment of the U. S. Constitution, and prior interpretations of it by the Court. The Due Process Clause has been found to limit states to imposing only taxes that bear fiscal relation to the protection, opportunities, and benefits given by the state. It requires that there be some definite link and minimum connection between a state and the person, property or transaction it intends to tax.

The Court ruled that the residence of trust beneficiaries in North Carolina alone does not supply the minimum connection necessary to enable North Carolina to tax the income of the trust. The reasons given were (1) the beneficiaries residing in North Carolina did not receive any income from the trust during the years involved, (2) the beneficiaries in North Carolina had no right to demand trust income or otherwise control, possess or enjoy the trust assets in those tax years, and (3) the beneficiaries also could not count on necessarily receiving any specific amount of income from the trust in the future.

The Court's decision has potential effect on persons who reside in Oklahoma and who are beneficiaries of trusts located in other states, if the facts and circumstances involved are like those in the *Kaestner* case.

Also, for a trust created, maintained and administered in Oklahoma that has beneficiaries who reside in other states, those states' authority to tax income of the Oklahoma trust may be limited if the facts and circumstances involved are like those in the *Kaestner* case.

If you would like to discuss the ruling of the Court in the *Kaestner* case, or other matters involving taxation of trusts and trust beneficiaries, please contact your GableGotwals attorney, or a member of our Tax Law Practice Group which includes:

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