

NEWSLETTER

Special Edition



ORAL ARGUMENTS IN UNITED STATES SUPREME COURT RAISE A FEW EYEBROWS ABOUT THE FUTURE OF STATE INCOME TAXATION OF TRUSTS

May 6, 2019 - Recent developments in a case before the United States Supreme Court are rapidly gaining the attention of estate planners everywhere. The case, Kaestner,¹ is on track to be decided in the next few months and is arguably one of the most significant trust taxation cases in recent decades.

The outcome of this case could significantly expand a state's authority to tax trusts in other jurisdictions. Specifically, the Court will rule on whether a state can tax the accumulated income of an out-of-state trust with no connection to the state other than the fact that a beneficiary resides there.

The outcome of this decision could have a far reaching impact on how states will choose to tax trusts going forward, as well as a client's decision to establish a new trust or revisit their current estate planning strategy. See below for further details.

Special Newsletter!

We ordinarily publish our tax newsletter once each quarter, or whenever there have been significant changes or developments at the federal and state level.

This most recent case before the United States Supreme Court, Kaestner, is certainly worth your attention.

While we are very closely tracking its development, it seems too close a call at this point to predict its ultimate outcome.



In this newsletter our Associate, Joe Romano, provides a summary of the main issue in this case and its potential with respect to future state action.

As always, please let me know of your comments and ideas to make our newsletter better.

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The Facts

Kaestner involved a father who created a trust in New York, and then split it into separate trusts for the benefit of his three children. One of the trust beneficiaries lived in North Carolina during the tax years at issue. Apart from the beneficiary's residence, her trust had no other link to North Carolina.

Pursuant to state law, North Carolina attempted to tax the trust on its accumulated income, even though it was not generated in North Carolina or distributed to the beneficiary that resided there. The North Carolina Supreme Court ultimately struck down the state's imposition of this tax, ruling that this was a violation of due process.

North Carolina subsequently appealed this decision to the U.S. Supreme Court. Oral argument concluded on April 16th, and the Court is now expected to rule whether it was unconstitutional for North Carolina to tax the New York-based trust.

The Issue

Although the Court has yet to issue a ruling in Kaestner, the impact of its decision could significantly increase a state's ability to tax out-of-state trusts. For example, states like New Jersey are currently authorized to tax out-of-state trusts with certain connections to the state, such as the in-state presence of trust assets or trustees.

In the past, the mere in-state presence of trust beneficiaries, without anything more, has been considered insufficient to warrant taxation. This is the main point of contention in Kaestner.

The Bottom Line

A ruling in favor of North Carolina would allow states to expand their powers to tax out-of-state trusts with resident beneficiaries by updating their laws or more aggressively applying their current tax regimes.

Such a result could, for example, subject a Delaware trust with a New Jersey resident beneficiary to taxation in New Jersey. Due to the novelty of this issue, however, the further reaching impacts of this decision remain uncertain.

Alternatively, if the Supreme Court finds that a beneficiary's residence is not enough to tax an out-of-state trust, then it would be a win for taxpayers and would avoid the administrative inefficiency of having to keep track of trust beneficiaries for reporting purposes.

In the event that the Court issues an unfavorable ruling, it may be necessary for certain clients to revisit their estate plans and discuss potential strategies to mitigate the impact of this result. Our firm is carefully monitoring this case and will provide updates as they become available.

- Joe Romano



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