

North Carolina Department of Revenue v. Kaestner Family Trust, No. 18-457

Today, the Supreme Court held in a unanimous decision that the Due Process Clause prohibits States from taxing undistributed trust income based only on the in-state residency of trust beneficiaries.

Background: A North Carolina statute imposes a tax on any trust income that “is for the benefit of” a North Carolina resident, and the State’s courts interpret this law to mean that a trust owes income tax to North Carolina whenever the trust’s beneficiaries live in the State—even if, as in this case, the trust income is never distributed to the in-state beneficiaries. The sole connection between the trust at issue in this case and North Carolina was the in-state residence of the trust’s beneficiaries. The trustee paid the tax under protest and sued in North Carolina state court, alleging that the tax violates the Due Process Clause of the Fourteenth Amendment. The North Carolina courts sided with the trustee and held that the State’s taxation of the trust based solely on the residency of the trust’s beneficiaries violated the Due Process Clause.

Issue: Whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries’ in-state residency.

Court’s Holding: In an opinion by Justice Sotomayor, the Supreme Court unanimously affirmed, holding that, under the specific facts of the case, the Due Process Clause prohibited North Carolina from taxing the undistributed trust income. The Court reiterated the two-step analysis to decide whether a state tax “abides by the Due Process Clause” criteria established by its prior decisions. First, there must be a “minimum connection” between the State and the person or property it seeks to tax. Second, the income attributed to the State for tax purposes must be “rationally related” to “values connected with the taxing State.”

The Court decided the case solely on the basis of the first requirement, holding that the requisite minimum connection was lacking. The Court observed, for example, that the beneficiaries did not receive any income from the trust during the years in question; had no right to demand trust income or control the trust assets; and also were not certain to receive any specific amount of income from the trust in the future.

Justice Alito authored a concurrence, in which Chief Justice Roberts and Justice Gorsuch joined, emphasizing the narrowness of the Court’s opinion, which “merely applies our existing precedent” and declines “to answer questions not presented by the facts of this case.”