

The Will & The Way

NORTH CAROLINA BAR ASSOCIATION

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The Chair's Comments



By Rebecca L. Smitherman

As we start a new NCBA year, I am very grateful to be serving as the chair of the Section for the 2018-2019 year. We are fresh off the Annual Meeting in Kiawah, South Carolina. The program and speakers this year were excellent, and

Smitherman

I appreciated the range of topics from high-level tax presentations to nuts and bolts of North Carolina practice. It makes me think of the wide breadth of clients we serve. We care for clients who have significant wealth as well as clients of modest means. One of the clerk speakers touted the value of attorneys in helping with insolvent estates, and it brought home for me the wide variety of things that our Section members do. I think that every attorney reaches a time when he or she says, "Why on earth did I sign up for this?" The answer to that question, in my mind, is that we do good for people. We help people, because we have knowledge and experience with a challenging system. We provide value to our clients. I want our Section to support our members in the work we do.

In line with the goals of the NCBA, it is my hope that our Section will provide great value to our members and that our Section Council will represent the interests of our members in the greater Bar Association. My goals for the year are to improve relations with the NCBA, to ensure that our corner of the legal profession is protected through advocacy for the profession and continued excellent education.

Our Section is particularly effective in providing top-quality CLE programs and networking opportunities. We have historically also been effective in up-

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Kaestner's Impact on NC Fiduciary Income Taxation

By Carl L. King

On June 8, 2018, the North Carolina Supreme Court affirmed lower court decisions that held North Carolina's state fiduciary income tax unconstitutional as imposed upon the income earned and accumulated by a nonresident trust. **Kimberly Rice Kaestner 1992 Family Trust v. N.C. Dep't of Rev.**, No. 307PA15-2, 2018 WL 2937823 (N.C. 2018) ("**Kaestner**"). This article, which serves as an update to a previously-published article following the initial Superior Court proceeding in the **Kaestner** case, explores the questions trustees and their tax advisors should ask and the steps they should consider now that the North Carolina Supreme Court has rendered its decision. See Carl L. King, "Kaestner and the Future of North Carolina Fiduciary Income Taxation", *The Will & The Way*, June 2015, at 1. This update focuses on the appellate opinions, the range of trusts that may qualify for refund treatment, how practitioners responded to the original **Kaestner** decision, and issues of trust taxation that remain unanswered.

Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue – Summary of Facts, Rulings, and Procedural Posture

Kimberly Rice Kaestner was a beneficiary of a family trust established under New York law in 1992. Kaestner relocated to North Carolina in 1997. The Connecticut trustee separated Kaestner's share of the family trust from the primary trust in 2006, forming the Kimberly Rice Kaestner 1992 Family Trust (the "Kaestner Trust") for the benefit of Kaestner and her three children. The trustee of the Kaestner Trust had sole discretion for all decisions regarding investments and distributions, and at no time during the years at issue did the trustee reside in North Carolina, hold or maintain trust property in North Carolina, or make distributions to any beneficiary in North Carolina. In tax years 2005–2008, the North Carolina Department of Revenue ("NCDOR") assessed income tax on the income accumulated in the Kaestner Trust based on N.C.G.S. Section 105-160.2, *Imposition of Tax in the Income Tax Act for Estates, Trusts, and Beneficiaries*. N.C.G.S. Section 105-160.2 provides that a tax may be imposed on the taxable income of estates and trusts that are "for the benefit of a resident of this State." The Kaestner Trust challenged this statutory clause under the Due Process and Commerce Clauses of the United States Constitution, as well as Article I, Section 19 of the North Carolina Constitution. The Kaestner Trust argued that the statute was unconstitutional because it subjected an out-of-state trust to taxation by the state of North Carolina based solely on the residence of its beneficiaries within the state. The state did not dispute the facts,

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The Chair's Comments, continued from the front page

dating North Carolina law to provide the best law for North Carolina citizens.

As we start the year, I want to look back and thank those who have done exemplary work over the past year. In particular, Linda Johnson worked tirelessly to represent our Section during her year as chair of the Section. Linda went the extra mile, attending Board of Governors meetings and working with NCBA leadership, to ensure that the issues specific to our practice area were appreciated and addressed. Thank you, Linda.

At our annual meeting in July at Kiawah Island, South Carolina, we recognized our council members whose terms expired in 2018: Andrea Chomakos, Janice Davies, Tanya Oesterreich, Parrish Peddrick and Heidi Royal. Our membership elected Andrea, Janice, Larry Moye, Adam Shealy and Mark Hale as council members, to serve a three-year term. Our membership also elected Jessica Hardin as treasurer of the Section, and David Lewis as secretary.

The work of our Section is carried out by our very active committees. I urge anyone interested in being more involved with the Section to sign up for a committee.

Our committees are:

Ad Hoc Committee. This committee handles the non-program logistics of our annual meeting, including working with our sponsors to make our annual meeting truly excellent. Our next annual meeting will be July 25-27, 2019, again at Kiawah Island, South Carolina. You can book your accommodations now, using the group code 12355. Our Ad Hoc Committee is chaired by Linda Johnson and Tanya Oesterreich.

CLE Committee. This committee has a long history of presenting truly outstanding programs on behalf of our Section. This year, the committee is chaired by Beth Wood and Caitlin Horne.

Communications/The Will & The Way. This newsletter is a valuable resource for our members, providing timely information and in-depth articles. It also gives members a great opportunity to publish articles. This year, Lucy Siler is the chair of *The Will & The Way*, and I am sure she would be glad for more article submissions, as well as editing help.

Estate Administration Manual. This committee is led by Anna Winger and Zac Lamb. It provides an excellent resource for North Carolina practitioners, and our Section members volunteer as editors and chapter authors.

Ethics Committee. Our Ethics Committee keeps abreast of relevant ethics opinions and provides feedback to our Council and the North Carolina State Bar on the issues. Bill Kratt and John Kelso co-chair this committee.

Fiduciary Litigation Committee. Our Fiduciary Litigation Committee has been furiously working on a new Fiduciary Litigation Manual, to be released later this year, in conjunction with a fiduciary litigation CLE. Christian Perrin and Michael Anderson co-chair this committee.

Legislative Committee. Our Legislative Committee works hard on proposing improvements and corrections to North Carolina's statutes, while responding to actions that come up during our General Assembly's sessions. Janice Davies is chair, and Kemp Mosley is vice chair.

Membership Committee. Ansley Cella is the chair of our Membership Committee, and she works hard to keep our membership growing.

Pro Bono Committee. Brooks Jaffa is stepping onto the Pro Bono Committee, which promotes projects where our skills can be used for the greater good. Of note, our Section has strong participation in Lawyer on the Line, and we have a new opportunity to provide pro bono services through the Free Legal Answers program – you just sign up online and give answers to people who qualify for free legal help. It is touted as “pro bono in your PJs.”

Technology Committee. Carter Webb heads up our Technology Committee, and he keeps the Council abreast of new opportunities to serve our members through technology improvements.

I believe that our Section is set up for another great year. I want to thank everyone involved, and encourage anyone who is not yet involved to sign up for a committee and get started.

and the parties filed cross motions for summary judgment on the constitutional questions in Superior Court.

The trial court granted summary judgment for the taxpayer, holding N.C.G.S. Section 105-160.2 unconstitutional as applied to the taxpayer. **The Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dep't of Rev.**, No. 12 CVS 8740, 2015 WL 1880607 at *2 (N.C. Sup. Ct, 2015). The trial court found that the trust beneficiaries' residence in North Carolina alone did not establish sufficient contacts by the trust with the state to impose taxation, nor did it have rational relation to values connected with North Carolina, both violations of requirements under the Due Process Clause and under Article I, Section 19 of the state Constitution. *Id.* The trial court also found that the beneficiaries' residence did not constitute activity by the trust having "substantial nexus to the taxing state" or "fairly related to services provided by the state," two requirements of the four-pronged analysis for determining constitutionality under the Commerce Clause. *Id.*; see also **Complete Auto Transit, Inc. v. Brady**, 504 U.S. 274 (1977) (laying out the four-pronged analysis for Commerce Clause constitutionality). The NCDOR appealed and the North Carolina Court of Appeals affirmed the trial court's decision that beneficiary residence does not create minimum contacts for a trust necessary to satisfy the requirements of Due Process or Article I, Section 19 of the state Constitution. The Court of Appeals chose not to take up for analysis either the violation of the second requirement of Due Process (values rationally related to the state) or the Commerce Clause violation. *Id.* at *3. The North Carolina Supreme Court affirmed the decision of the Court of Appeals on the same basis, also not addressing the issues beyond the failed minimum contact requirement under Due Process.

As a matter of constitutional interpretation, the Commerce Clause, a narrower legal standard than Due Process rights, requires that a valid tax statute must "limit the reach of State taxing authority so as to ensure that State taxation does not unduly burden interstate commerce." The four-part test for determining whether the foregoing standard is met requires that the statute:

- (1) Apply to an activity with a *substantial* nexus with the taxing state;
- (2) Be fairly apportioned;
- (3) Not discriminate against interstate commerce, and
- (4) Be fairly related to the services provided by the state.

Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (emphasis on factors courts consider particularly relevant to constitutionality of state taxing authority), citing **Complete Auto Transit, Inc. v. Brady**, 430 U.S. 274 (1977). In **Kaestner**, because the Court of Appeals and Supreme Court held that N.C.G.S. Section 105-160.2 was unconstitutional as applied to the Kaestner Trust under the first prong of the Due Process clause analysis (i.e., the lower hurdle), those appellate courts did not inquire whether N.C.G.S. Section 105-160.2 cleared the higher hurdle presented by the Commerce Clause.

Constitutional Inquiry and Statutory Interpretation Required Under "As Applied" Analysis

After the **Kaestner** decision, the critical question for fiduciaries of trusts with North Carolina connections is the applicability of **Kaestner's** holding to other trusts with facts and circumstances that vary from the Kaestner Trust's facts.

"As Applied" vs. Facial Challenge to Statutes. The judiciary has the power to determine that a statute is unconstitutional *on its face*, or alternatively that it is unconstitutional *as applied* to a particular taxpayer. Procedurally, a plaintiff such as the Kaestner Trust chooses to bring either a facial challenge or an "as applied" challenge to a statute such as N.C.G.S. Section 105-160.2.

In **U.S. v. Stevens**, the U.S. Supreme Court stated, "To succeed in a typical facial attack, [the respondent] would have to establish "that no set of circumstances exists under which [the statute] would be valid", **United States v. Salerno**, 481 U.S. 739, 745 (1987), or that the statute lacks any "plainly legitimate sweep", **Washington v. Glucksberg**, 521 U.S. 702, 740, n. 7 (1997) (Stevens, J., concurring in judgments) (internal quotation marks omitted). **U.S. v. Stevens**, 130 S. Ct. 1577 (2010).

The U.S. Supreme Court has expressed reluctance to uphold fa-cial challenges for important jurisprudential reasons.

"Claims of facial invalidity often rest on speculation. As a consequence, they raise the risk of "premature interpretation of statutes on the basis of factually barebones records." **Sabri v. United States**, 541 U.S. 600, 609 (2004) (internal quotation marks and brackets omitted). Facial challenges also run contrary to the fundamental principle of judicial restraint that courts should neither "anticipate a question of constitutional law in advance of the necessity of deciding it" nor "formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied." **Ashwander v. Tennessee Valley Authority**, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring). Finally, facial challenges threaten to short circuit the democratic process by preventing laws embodying the will of the people from being implemented in a manner consistent with the Constitution. We must keep in mind that "[a] ruling of unconstitutionality frustrates the intent of the elected representatives of the people." **Ayotte v. Planned Parenthood of Northern New Eng.**, 546 U.S. 320, 329 (2006)."

Washington State Grange v. Washington State Republican Party, 552 U.S. 442 (2008).

Stare Decisis. Even though the **Kaestner** courts held N.C.G.S. Section 105-160.2 to be unconstitutional *as applied* to the trustee of the Kaestner Trust, a single fiduciary taxpayer, the decision likely is far reaching.

At a fundamental level, the U.S. Supreme Court repeatedly has supported the doctrine of *stare decisis*. "In constitutional cases, the doctrine [of *stare decisis*, i.e., following legal precedent] carries such persuasive force that we have always required a departure from precedent to be supported by some 'special justification.'" **Payne v. Tennessee**, 501 U.S. 808 (1991), citing **Arizona v. Rumsey**, 467 U.S. 203, 212 (1984); see **Quill Corp. v. North Dakota**, 504 U.S. 298 (1992) (concerning the application of *stare decisis* in the context of an unconstitutional state tax statute); *c.f.*, **Burnet v. Coronado Oil & Gas Co.**, 285 U.S. 393, 405 (1932) (Brandeis, J., dissenting).

Indeed, in its petition to the North Carolina Supreme Court to review the Court of Appeals' decision in **Kaestner**, the state, itself,

accurately observed “the potential widespread impact of the Court of Appeals’ decision....” *Petition in Kaestner*, No. 307 P15-2 (N.C., July 22, 2016), p. 9.

Statutory Interpretation in the Context of “As Applied” Analysis. Furthermore, when a trustee analyzes the applicability of **Kaestner**’s holding to a trust, the trustee should apply the statute, itself, to the taxpayer’s facts. This analysis specifically should include a statute’s specific scope.

In **Fielding v. Commissioner of Revenue**, a case decided in a sister state during the pendency of the **Kaestner** proceedings, the Minnesota Tax Court described this important statutory analysis succinctly:

“[A]s-applied challenges are analyzed under all the *relevant* circumstances.... The Commissioner simply assumes, however, that *all* the contacts between Minnesota and the Trusts are relevant when applying section 290.01, subdivision 7b(a)(2). We cannot agree. When evaluating a constitutional challenge to a statute, a court must first determine the statute’s meaning; must next apply the statute in accordance with legislative intent; and only then must decide whether the statute, as applied, violates the constitution.... We will not, as the Commissioner requests, consider other (nexus) factors such as the storage in Minnesota of trust instruments or the Minnesota domicile of a beneficiary.”

Fielding v. Commissioner of Revenue, 2017 WL 2484593, p. 24 & 27 (2017) (emphasis added), *affirmed by Fielding v. Commissioner of Revenue*, --- N.W.2d --- (2018), 2018 WL 3447690. Minnesota’s tax act includes a so-called “founder” fiduciary income tax statute, where jurisdiction to tax purportedly rests solely on the domicile of the grantor when the trust becomes irrevocable. As a matter of statutory application, the **Fielding** courts properly ignored facts that, in theory, might provide constitutional nexus under a broader statute, but were *irrelevant* to the sole factor used to determine nexus under Minnesota’s existing tax act. *See also Wal-Mart Stores East, Inc. v. Hinson*, 197 N.C. App. 30 (2009) (adopting consistent principles of statutory interpretation in North Carolina; “The primary indicator of legislative intent is statutory language; the judiciary must give clear and unambiguous language its plain and definite meaning.... Tax statutes are to be strictly construed against the State and in favor of the taxpayer.”), *citing Proposed Assessments v. Jefferson-Pilot Life Ins. Co.*, 161 N.C. App. 558, 560 (2003).

Applying a similar analysis to N.C.G.S. Section 105-160.2, which, for “resident” trusts, hinges solely on facts related to the presence of a North Carolina domiciled beneficiary, advisers should “ask whether the [domicile of the beneficiary]—standing alone—is a sufficient connection upon which to justify taxing the Trusts as [North Carolina] residents.” *See* analogous quote in **Fielding**, *supra*. *See also In Re Swift*, 727 S.W.2d 880 (Missouri, en Banc, 1987) (declaring as unconstitutional a statute based solely on domicile of the settlor of testamentary trusts, and suggesting that a state fiduciary income tax statute needs more than just one contact to be constitutional, e.g., more than merely the domicile of the grantor at death or the domicile of beneficiaries). In the **Kaestner** cases, the domicile of the North Carolina beneficiaries—standing alone—was an insufficient connection upon which to justify taxing the trusts as North Carolina resident trusts.

Accordingly, when evaluating the “as applied” constitutionality of N.C.G.S. Section 105-160.2, a trustee first must determine the statute’s meaning; next must apply the statute in accordance with legislative intent (*i.e.*, apply facts *relevant* to the statute); and only then must decide whether the statute, as applied, violates the constitution.

Use of the Foregoing “As Applied” Analysis after **Kaestner**

Trustees and their counsel might use the foregoing analysis when assessing common types of trusts that might be “resident trusts” under N.C.G.S. Section 105-160.2. Since the North Carolina Supreme Court did not hold N.C.G.S. Section 105-160.2 unconstitutional on its face, it is appropriate to ask whether the “set of circumstances exists under which [the statute] would be valid.” **U.S. v. Stevens**, *supra*, *citing United States v. Salerno*.

As an extension of that analysis, important questions trustees should ask include:

- *Does the subject trust have a beneficiary domiciled in North Carolina?* Under a proper statutory analysis, this is the *only fact* that is relevant to determine resident trust status under N.C.G.S. Section 105-160.2. Importantly, under **Kaestner**, the analysis of taxability no longer ends with the answer to this question. Indeed, in **Kaestner** all current beneficiaries were North Carolina residents, yet the Kaestner Trust was not a constitutionally-taxable resident trust.
- *Does the North Carolina beneficiary have a vested right to undistributed taxable income?* For example, a vested right might arise from the capital gains arising from an asset specifically earmarked for a North Carolina beneficiary under the governing instrument, but sold by the trustee. Because IRC Section 652(a) includes in the gross income of the beneficiary all of the fiduciary accounting income of so-called simple trusts (or separate shares of trusts which operate as simple trusts) “required to be distributed” to a beneficiary “whether distributed or not,” in many cases the beneficiary, and not the fiduciary, will be taxable on such income. But, in situations where the fiduciary is taxable on gain specifically earmarked for a beneficiary under the governing instrument, perhaps that is a circumstance in which a North Carolina court would find the statute to be constitutional “as applied.”
- *Does the North Carolina beneficiary hold a general power of appointment—especially an inter vivos general power of appointment—over trust assets?* While it is not entirely clear that a general power of appointment would cause state income taxation of the trust for undistributed taxable income, it seems that a strong case could be made that a North Carolina beneficiary-power holder has sufficient rights to cause taxation. In this context, it is possible that a so-called “5 and 5 power” in the trust could result in North Carolina state income taxation. The undistributed income arising from a portion of a trust over which a North Carolina domiciled beneficiary holds a hanging Crummey power similarly might be subject to state income taxation.
- *If the trust includes multiple beneficiaries, only some of whom are domiciled in North Carolina, are all beneficial rights identical?* If not, there is a strong argument that the NCDOR’s established practice under 17 NCAC 6B.3724(b) of apportioning income *per capita* among beneficiaries, regardless of the nature or value

of each beneficiary's interest, is unconstitutional *as applied* to such trusts under the fourth prong of the Commerce Clause, since taxation is not fairly apportioned to the services provided by the state. **Complete Auto Transit, Inc. v. Brady**, *supra*.

- *Are the North Carolina beneficiaries' interests in the trust subject to a substantial contingency? As a notable example, is the trust a discretionary trust for the benefit of multiple beneficiaries, any of whom are not, or in the future might not be, domiciled in North Carolina?* Compare the laws of states that also use domicile of beneficiaries as a factor in determining residency of a trust. For example, in Georgia, there is no clear statutory or regulatory authority as to when a trust is considered resident, but by analogy, for purposes of withholding tax on transfers of Georgia real property, a trust with Georgia beneficiaries is *nonresident* if administered by a nonresident fiduciary. Ga. Comp. R. & Regs. 560-7-8-.35(1)(d). *See also* Cal. Rev. & Tax. Code §§ 17041(a)(1), 17043(a), 17742(a) (including elaborate and expensive-to-administer "claw back" provisions for distributions made to California trust beneficiaries within 5 years of earning undistributed trust income).
- *Was the trust formed by a grantor domiciled in North Carolina; did the trust become irrevocable when the grantor was domiciled in North Carolina; does a trustee reside in North Carolina; does the principal place of administration occur in North Carolina?* These questions should be red herrings and irrelevant to a proper statutory analysis since none of these facts are applicable under N.C.G.S. Section 105-160.2 and such facts are not within the scope of the statute's legislative intent. The courts in the **Kaestner** case had no cause to interpret the statute in light of such facts since all other contacts were outside North Carolina. Whether a court might hold that additional contacts in North Carolina are relevant under our statute remains an open question.

Examples of Trusts Where N.C.G.S. Section 105-160.2 Might Be Constitutional "As Applied"

Description of Trust	Comment
Marital trusts granting a general power of appointment—especially an inter vivos power—to a North Carolina domiciled beneficiary, such as certain older trusts qualifying for the marital deduction under IRC § 2056(b)(5).	To avoid problems with disparate beneficial interests under 17 NCAC 6B.3724(b), such a trust would need to be payable outright to the spouse at some date or to the spouse's estate.
Trusts exclusively for the benefit of individual beneficiaries who are residents of North Carolina, such as trusts qualifying for the GST annual exclusion under IRC Section 2642(c).	After Kaestner , the beneficiary also likely must hold some form of vested right to undistributed taxable income. Otherwise, it is unclear that the trustee of a discretionary trust ever will pay income to a North Carolina beneficiary (<i>i.e.</i> , the beneficiary may move to a different state prior to any distribution).

Examples of Trusts Where N.C.G.S. Section 105-160.2 May Be Unconstitutional "As Applied"

Description of Trust	Comment
Trusts without any contact with North Carolina other than beneficiaries domiciled in North Carolina.	These are the Kaestner facts. Arguably, no other fact is <i>relevant</i> for determining resident trust status under N.C.G.S. Section 105-160.2. <i>See Fielding, supra</i> .
Discretionary trusts benefitting multiple beneficiaries with varying interests across more than one generation.	The presence of the trustee's discretion, as a substantial contingency, makes it difficult for the NCDOR to show that undistributed income is "for the benefit" of any North Carolina beneficiary.
Marital "QTIP" trusts qualifying under IRC Section 2056(b)(7).	<i>Per capita</i> income taxation of disparate beneficial interests under 17 NCAC 6B.3724(b) appears unconstitutional "as applied" by North Carolina under the Commerce Clause.

What Actions Have Trustees and Practitioners Taken?

In the author's view, it is important to share with the Estate Planning and Fiduciary Law Section that the legal positions described above are not merely hypothetical. Following the 2015 Complex Business Court decision in **Kaestner**, trustees successfully have taken a variety of approaches to the proper, constitutional application of N.C.G.S. Section 105-160.2. Arguably, trustees may have an affirmative duty to closely consider these questions when discharging their administrative duties in the best interest of trusts' beneficiaries. *See* N.C.G.S. Section 36C-1-108(b).

For years going back to 2011 (open under the three-year statute of limitations under N.C.G.S. Section 105-241.8 at the time that the trial court issued its decision in **Kaestner**), anecdotal evidence is that the NCDOR properly and broadly has granted taxpayer requests to extend the statute of limitation under N.C.G.S. Section 105-241.6(b) (5), North Carolina's relatively young (2014) post-deprivation remedy statute.

For tax years following the trial court opinion in **Kaestner**, including 2014 and later calendar years, many trusts have paid income tax under the strictest interpretations of N.C.G.S. Section 105-160.2 and 17 NCAC 6B.3724(b) followed by refund claims based on the Commerce Clause, fairly apportioning trust income among beneficiaries as determined by trustees in the reasonable exercise of their fiduciary discretion.

Moving forward, some trustees might take the reasonable position that N.C.G.S. Section 105-241.6(b)(5), North Carolina's post-deprivation remedy statute, has not overturned the law described in **Bailey v. State**, 348 N.C. 130, 166, 500 S.E.2d 54, 75 (1998) (a.k.a., "**Bailey II**"). Procedurally, **Bailey II** stands for two interesting propositions. First, when the state had notice that tax legislation was potentially unconstitutional and had opportunity to budget for that contingency before the case was brought, the refund was available to all taxpayers who wrongfully had their benefits impaired by the state, not just those who complied with the statutory requirements for the refund claims. The court held that since "the State unconstitutionally collected taxes from all of these individuals . . . [i]t would

be unjust to limit recovery only to those taxpayers with the advantage of technical knowledge and foresight to have filed a formal protest and demand for refund.” *Id.* See also **Reich v. Collins**, 513 U.S. 106, 115 S.Ct. 547 (Dec. 6, 1994). In the wake of **Kaestner**, many fiduciary taxpayers, including those without expensive legal and tax consulting advice on retainer, might be able to file a claim for refund under **Bailey II**.

Second, as a related matter, **Bailey II** acknowledges the fundamental inequity of treating similarly-situated taxpayers differently. Where the General Assembly has failed to act to amend N.C.G.S. Section 105-160.2 in a constitutional matter, the NCDOR is left to apply the fiduciary income tax in a case by case manner. Other states have faced and failed equitable challenges to similarly problematic approaches to fiduciary income tax statutes. “[T]he government [should] deal fairly with its citizens, eschewing inequitable practices.... [S]tatutory provisions governing substantive standards and procedures for taxation, including the administrative review process, are premised on the concept that government will act scrupulously, correctly, efficiently, and honestly.... That is, an agency may not spring upon the regulated community a new policy, never before announced, and apply it retroactively.... [This] doctrine is particularly important in the field of taxation, because trusts, businesses, individuals and others must be able to reliably engage in tax planning and, to do so, they must know what the rules are.” **Residuary Trust A u/w Kassner v. Director, Division of Taxation**, Docket No. 0A-3636-12T1 (N.J. Super. Ct. App. Div. 2015) (citations omitted).

Proposed Legislation

North Carolina deserves a better fiduciary income tax statute. The Legislative Committee of the Estate Planning and Fiduciary Law Section of the North Carolina Bar Association actively has been involved in developing a proactive solution to the constitutional defects of N.C.G.S. Section 105-160.2. In 2015, the North Carolina Senate proposed legislation that had been recommended by our Legislative Committee, resulting in 2015 *S.B. 468*—a proactive effort to make our statute constitutional in 2015. <https://legiscan.com/NC/text/S468/2015>. While that legislation passed the Senate’s “Judiciary I” committee in 2015, it stalled in **Kaestner’s** headwinds (prior to the time the appellate decision was rendered) and again during the legislative Long Session in 2017. To date, the proposal has not been scored by the Senate Finance Committee (i.e., the committee has not determined whether or the extent to which the proposal is revenue-neutral, or not).

Currently, the NCBA plans to re-introduce the proposed revisions to the fiduciary income tax statute, N.C.G.S. Section 105-160.2., for the 2019 Long Session of the General Assembly. This likely will be equivalent, if not identical, to the proposal we submitted in 2014 (for the 2015 Long Session) that became 2015 *S.B. 468*. The NCBA is working to gain support directly from legislators and affinity groups, such as the North Carolina Banker’s Association.

A Final Note Concerning Wayfair

On June 21, 2018, the U.S. Supreme Court decided **South Dakota v. Wayfair, Inc.**, 585 U.S. ____ (2018), holding that a state may require out-of-state sellers to withhold sales tax even if the seller does not have a physical presence in the taxing state. **Wayfair** has overturned the physical presence requirement of **Quill Corp. v. North Dakota**, *supra*, (in the state sales tax context) for constitutionality under the Commerce Clause. However, **Wayfair** should not be read too broadly, as the Supreme Court upheld both the “purposefully directed” Due Process test and the four-part **Complete Auto Transit** Commerce Clause

test (substantial nexus, nondiscrimination, fair apportionment, and fair relationship to services provided by the state) supported in **Quill**. **Wayfair** appears to uphold the fundamental tests in **Quill**, but says that the tests were—or, now are, in the age of internet commerce—improperly applied by requiring the physical presence of the business provider. **Wayfair** now requires a more nuanced application of the **Complete Auto Transit** test in every case, something the **Kaestner** court, especially the Business Court, did well.

Query whether, for large corporate trustees, some states might pursue a theory as follows: Just as **Wayfair** (and others) sold furniture to customers in South Dakota without a physical presence, but nonetheless with a substantial nexus to that state, similarly might large trust companies providing trust services to beneficiaries in states in which the trust companies do not have a physical presence have a sufficient nexus to those states? See **Bank of America, N.A., Trustee v. Commissioner of Revenue**, 474 Mass. 702 (2016) (corporate trustee held to be “inhabitant” of Massachusetts based on the bank’s presence and trust-related activities performed generally in Massachusetts (200 branches) on behalf of the 35 subject trusts even though its principal place of business was in North Carolina. Massachusetts is a “Founder Trust” state, but, for inter vivos trusts, with the added requirements of resident beneficiaries and an “inhabitant” Massachusetts trustee).

While a detailed discussion is beyond the scope of this article, there is an important distinction between the **Wayfair** furniture company and all trustees, including trust companies. Legal ownership of property by a fiduciary for a person’s benefit fundamentally is not the same as purposefully directing a product to an online customer. Often, as in **Kaestner**, after the grantor and the trustee make their contract (i.e., the original trust agreement), the trustee has no control over where the beneficiary may move, and a trustee’s legal title to the trust property is not akin to commercial activity.

Conclusion

Following the North Carolina Supreme Court decision in **Kaestner**, the critical question for fiduciaries of trusts with North Carolina beneficiaries and other connections is the applicability of **Kaestner’s** holding to trusts with different facts and circumstances. However, the **Kaestner** court’s holding that N.C.G.S. Section 105-160.2 is unconstitutional “as applied” to the Kaestner Trust, rather than on its face, does not mean that there is not “potential widespread impact of the Court[’s] decision,” in the words of the NCDOR. Indeed, a careful Constitutional inquiry and the statutory interpretation required under an “as applied” analysis both suggest that **Kaestner** likely applies to many common trusts. Fiduciaries and their counsel should closely review trusts for potential refund claims and appropriate reporting positions consistent with the Due Process and Commerce Clauses of the U.S. Constitution, where N.C.G.S. Section 105-160.2 otherwise is inadequate. Members of the Estate Planning and Fiduciary Law Section also should support efforts to pass a constitutional and equitably-administered fiduciary income tax statute in North Carolina.

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