Perspective

Constitutional Limitations

Taxpayers and their advocates must know the limitations of a state's authority to impose tax on trust income. In this second of a two-part series, Thomas W. ''TJ'' Aldous of Williams Mullen reviews constitutional principles related to imposing income tax on trusts and discusses how to reconcile seemingly divergent court decisions. Last week, in part one of the series, Aldous used Virginia law as a lens through which to review basic principles regarding the nature of trusts and trust income, including triggers of trust income tax liability.

Taxation of Trust Income: What Are the Constitutional Limitations to Impose Tax, and Are States Adhering to Them?

By Thomas W. ''TJ'' Aldous

Thomas W. ''TJ'' Aldous Jr. is a partner with Williams Mullen's Private Client & Fiduciary Services Team, where he concentrates his practice on estate, gift, generation-skipping and fiduciary income taxation, estate planning, estate and trust administration (including the preparation of fiduciary income tax returns and estate tax returns), and fiduciary litigation. He has advised high net-worth individual and corporate clients on matters involving asset protection trusts, family trust companies, unitrust conversions, the construction and reformation of governing documents. Aldous also counsels clients on charitable conservation donations and the use of Virginia land preservation tax credits.

As states more aggressively seek to impose taxes on trusts, some practitioners may question whether the states are exceeding their constitutional authority.

U.S. Supreme Court cases considering whether a state could constitutionally tax a trust have been based on an understanding of basic trust principles. However, some courts and state tax departments have seemingly misunderstood the nature of a trust and this, in turn, has caused uncertainty. Further, states have a financial incentive to define resident trusts broadly, because the state generates more revenue by taxing the worldwide income of a resident versus the tax on source income of a nonresident.

This week, this second article in a two-part series offers a discussion of constitutional issues that come up when states try to impose income tax on trusts, including concerns regarding the Due Process Clause and Commerce Clause. Then, it addresses divergent court

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opinions from various states and offers insight on how to reconcile them.

The first installment of this article, published in early April, used Virginia examples to discuss trust income tax triggers and to illustrate the broader implications of income tax on trusts.

Constitutional Issues

Unless limited by the federal Constitution, the power of a state as to mode, form, and extent of taxation is unlimited so long as the subjects to which it applies are within the state's jurisdiction.[1] Determining whether a state has jurisdiction is not formulaic. The U.S. Supreme Court's decisions can appear inconsistent and irreconcilable. State court decisions conflict. Jurisdictional issues can sometimes focus more on states' rights and less on protecting the expectations and rights of the taxpayer.[2]

Due Process Limits on State Taxation Authority

The Due Process Clause of the Fourteenth Amendment requires ''some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.''[3] The requirements to satisfy due process have evolved over time. Generally, a state may exercise jurisdiction if the state has ''just control''[4] over the taxpayer or if the taxpayer has ''purposefully availed''[5] himself of the benefits and protections of the state.[6]

Minimum Contacts

Due process requires that a state have minimum contacts with the person it seeks to tax. In matters involving trusts, a determinative question is who is the taxpayer with whom the state must have contacts? Is it the trustee, who holds legal title, or is it the trust, as a separate entity, or can a state consider the interests of the beneficiaries or even the settlor?

In jurisdictional matters, the trustee has always been the required link to the state. In Virginia, a trustee is a necessary party to a suit involving a trust, and a suit must be brought against a trustee and not the ''trust.''[7] At the federal level, in matters involving a trust, a court must have jurisdiction over the trustee. In *Hanson v. Denckla*,[8] the settlor and the beneficiary were present in Florida, but the trustee was not. The U.S. Supreme Court decided that Florida's jurisdiction over the settlor and beneficiary did not give Florida jurisdiction over the nonresident trustee.[9] Similarly, for purposes of determining federal diversity of citizenship, the Supreme Court has held that citizenship of the trustee and not the seat of the trust or the residence of the beneficiary determines whether there is diversity.[10] To regulate a trust,[11] a state must have jurisdiction over the trustee. Therefore, one would expect that the state must have ''just control'' over a trustee and that the trustee must purposefully avail himself or herself of the benefits and protections of the state.[12]

Limitations

Due process requirements effectively limit the extent of a state's jurisdiction. If a person lives or operates outside of a state, the state may only exercise jurisdiction to the extent the person has specifically invoked the protections and benefits of its laws.[13] This is specific jurisdiction. If a person lives in or is otherwise ''at home'' in the state, the state may be able to exercise general ju-

[1] *Shaffer v. Carter*, 252 U.S. 37, 52 (1920). A state, without the consent of Congress, cannot lay imposts or duties on imports or exports under U.S. Const. art. I, §10, cl. 2, a state cannot lay any tonnage duties under U.S. Const. art. I, §10, cl. 3, and a state cannot discriminate against interstate commerce under the Commerce Clause of U.S. Const. art. I, §8, cl. 3. The Due Process Clause of the Fourteenth Amendment limits a state's taxing power. Courts consider the type of tax (such as sales, use, income, property, etc.) as well as the identity of the taxpayer (such as corporation, partnership, individual, trust). *See also, e.g., Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287 (1998) (discussing taxpayer's contention that a tax can violate the privileges and immunities clause). The taxation of income of nonresidents does not violate the impairment of contracts provision of the Constitution. *See Carter*, 252 U.S. at 52.

[2] *Cf.* Anthony J. Colangelo, *Spatial Legality*, 107 Nw. U. L. Rev. 69 (2012) (discussing how state interests have marginalized individual rights).

[3] *See Carter*, 252 U.S. at 52; *J. McIntyre Mach. Ltd. v. Nicastro*, 131 S. Ct. 2780, 2011 BL 168067 (2011); *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954).

[4] *Carter*, 252 U.S. at 52.

[5] *See J. McIntyre Mach. Ltd. v. Nicastro*, 131 S. Ct. 2780 (2011) (discussing ways a person may submit to a state's authority, including explicit consent, presence within a state at the time suit begins through service of process, citizenship or domicile, or by being involved in disputes that ''arise out of or are connected with the activities within the state.'')

[6] *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 474-75 (1985) (quoting *Hanson v. Denckla*, 357 U.S. 235, 253 (1958)); *Int'l Harvester Co. v. Wisconsin Dept. of Taxn.*, 322 U.S. 435 (1944).

[7] *Fisher v. Dickenson*, 4 S.E. 737, 742, 84 Va. 318, 329 (Va. 1888) (holding that a trustee is a necessary party in a suit where the trust subject is in litigation); *Yonce v. Miners Memorial Hospital Assn.*, 161 F. Supp. 178, 188 (W.D. Va. 1958) (stating that a suit must be brought against the trustees and not against the fictional entity); *Ryan v. Commonwealth*, 193 S.E. 534, 169 Va. 414 (Va. 1937) (stating that Virginia did not have jurisdiction to tax a New York trustee). *See also Matijkiw v. Strauss*, No. 2008 CA 004996 B, 2011 D.C. Super. LEXIS 13, 14 (D.C. Super. Ct. June 17, 2011); *Randolph Found. v. Appeal from Probate Court of Westport*, No. XO5CV980167903S, 2001 Conn. Super. LEXIS 953 (Conn. Super. Ct. Apr. 3, 2001).

[8] 357 U.S. 235 (1958).

[9] By comparison, jurisdiction over a corporation does not give jurisdiction over the shareholders. *Shaffer v. Heitner*, 433 U.S. 186 (1977). A state does not have jurisdiction to tax a nonresident subsidiary of a parent, nor does it have jurisdiction to tax a nonresident parent of a subsidiary. *See, e.g., In re Washington Mutual Inc.*, 485 B.R. 510 (Bkrtcy. D. Del. 2012); *Current, Inc. v. California St. Bd. of Equal.*, 24 Cal. App. 4th 382, 29 Cal. Rptr. 407 (1st Dist. 1994); *SFA Folio Collections Inc. v. Tracy*, 73 Ohio St. 3d 119, 652 N.E.2d 693 (Ohio 1995).

[10] *See Navarro Sav. Assn. v. Lee*, 446 U.S. 458 (1980); *Bullard v. Cisco*, 290 U.S. 179 (1933); *Memphis S. R. Co. v. Moore*, 243 U.S. 299 (1917).

[11] *See Quill Corp. v. North Dakota*, 504 U.S. 298, 319 (1992) (Scalia J., concur).

[12] When filing a tax return, a trustee is required to pay the tax and file the return.

[13] *See J. McIntyre Mach. Ltd. v. Nicastro*, 131 S. Ct. 2780 (2011); *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 474-75 (1985) (quoting *Hanson v. Denckla*, 57 U.S. 235, 253 (1958)); *Int'l Harvester Co. v. Wisconsin Dept. of Taxn.*, 322 U.S. 435 (1944).

risdiction over the person and resolve matters based on activities outside the state.[14]

The same principles apply when imposing a tax. A state can impose an income tax on its residents,[15] even if the income is earned outside of its jurisdiction.[16] A state may only tax a nonresident's income that is derived from a source within the state, such as from property or business within the state.[17]

What Contacts With a Trust Are Sufficient?

When a trustee is not present in the state, states, like Virginia, rely on the state's contacts with the settlor, the beneficiaries or trust assets to assert jurisdiction and they ignore the elements of just control over the trustee and purposeful availment by the trustee.[18]

Presence of Trust Assets

A state may argue that the presence of trust assets in the state grants jurisdiction. In *Shaffer v. Heitner*, a decision by the U.S. Supreme Court, the plaintiff sued present and former directors of a corporation incorporated in Delaware whose principal place of business was in Arizona. In the derivative suit, the plaintiff alleged the defendants had violated their duties to the corporation by causing it to engage in actions that resulted in substantial damages and criminal fines.[19] To compel the personal appearance of the nonresident defendants to answer and defend the suit, Delaware seized the stock of the defendants. The Supreme Court noted that Delaware's sole basis for jurisdiction was the defendants' stock ownership. Relying on the minimum contacts necessary to establish tax jurisdiction under *International Shoe*,[20] the court held that Delaware did not have jurisdiction.[21]

Shaffer v. Heitner made clear that a state cannot assert general jurisdiction based simply on the presence of property within the state.[22] The presence of trust assets could be a sufficient contact to give the state specific jurisdiction to tax the income from the assets as source income. As a general matter, however, the presence of trust assets in Virginia should not be sufficient to tax the trust as a resident trust.[23]

[T]he presence of trust assets in Virginia should not be sufficient to tax the trust as a resident trust.

Presence of Beneficiary

Some states assert nexus and tax a trust based on the presence of a beneficiary in the state. In *Hanson v. Denckla*,[24] the U.S. Supreme Court considered whether Florida had jurisdiction over a Delaware trustee. The trust had been created by a Pennsylvania settlor who later became domiciled in Florida. The settlor retained the right to income and had a right to revoke the trust. While in Florida, the settlor exercised a power of appointment over the trust assets that would take effect at the settlor's death. After the settlor's death, Florida determined that the exercise of the power of appointment was testamentary and not validly exercised under Florida law. Delaware refused to give full faith and credit to the Florida decree and determined that the assets held in the trust by the Delaware trustee passed in accordance with the power of appointment. On appeal to the U.S. Supreme Court, the court considered the settlor to be the ''owner'' of the trust assets, which the parties agreed had situs only in Delaware. The court held that Florida lacked *in rem* jurisdiction over the trust assets, even though the settlor domiciled in Florida was the deemed owner of the assets. It held that a probate decree could not have an *in rem* effect on the interests in the intangible property of a nonresident over whom Florida had no personal jurisdiction.[25] Similarly, Florida had no personal jurisdiction over the trustee because the trustee performed no acts in Florida, other than paying the income of the trust to the settlor. The fact that the settlor, while in Florida, exercised a power of appointment over the trust assets also did not give Florida jurisdiction over the trustee.

If a trustee is not present in the state, it seems unlikely that the presence of a beneficiary should confer minimal contacts necessary under the Due Process Clause to tax the trust as a resident trust.[26] Certainly a

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[14] *Goodyear Dunlop Tires Operations v. Brown*, 131 S. Ct. 2846, 2851 (2011).

[15] *Shaffer v. Carter*, 252 U.S. 37, 52 (1920); *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 75 (1920).

[16] *Oklahoma Tax Comn. v. Chickasaw Nation*, 515 U.S. 450, 453 (1995).

[17] *See Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938); *Shaffer v. Carter*, 252 U.S. 37, 52 (1920). Only the state where tangible personal property or real estate is located can impose a property tax on that property, but the state where the owner of that property resides can tax the income earned on that property even though it cannot impose a property tax. *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947). Because intangible personal property has no situs, the state where the owner of the intangible personal property resides can impose a property tax on that intangible personal property and can tax the income earned on that property. The state where evidence of the intangible personal property is located may also be able to impose a tax on the property. *Utah Tax Comn. v. Aldrich*, 316 U.S. 174 (1942).

[18] The concepts of ''just control'' and ''purposeful availment'' are typically discussed in cases involving entities that do business in more than one state. *See, e.g., Int'l Shoe Co. v. Washington*, 326 U. S. 310, 317 (1945). A trust, however, is often a passive investor that does not actively and directly participate in a business as a sole proprietorship.

[19] 433 U.S. 186, 189 (1977).

[20] *Int'l Shoe Co. v. Washington*, 326 U. S. 310 (1945).

[21] *Shaffer v. Heitner*, 433 U.S. 186, 189, 213 (1977).

[22] *Shaffer v. Heitner*, 433 U.S. 186 (1977). *See also, Hellerstein & Hellerstein, State Taxation*, ¶ 6.11[2] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2013) (online version accessed on Checkpoint (www.checkpoint.riag.com) Dec. 1, 2013).

[23] *See* footnotes 54 through 58 and accompanying text where the constitutionality of this position is questioned.

[24] 357 U.S. 235 (1958).

[25] *Hanson*, 357 U.S. at 249.

[26] ''The 'broad inquiry' subsumed in both Due Process and Commerce Clause constitutional requirements is 'whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state'—that is, 'whether the state has given anything for which it can ask re-

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beneficiary's personal equitable interest in the trust assets is insufficient to give a state jurisdiction or ''just control'' over a nonresident trustee. It was insufficient in *Hanson v. Denckla* and it was insufficient in *Safe Deposit*,[27] discussed hereafter.

The U.S. Supreme Court has considered whether due process was satisfied in cases involving *ad valorem* taxes and income taxes imposed on trustees and on beneficiaries.[28] In cases where an income tax was considered, the U.S. Supreme Court determined that the state where the trustee resided could tax all of the trust's income, whether or not distributed to the beneficiary.[29] The state where a trust beneficiary resided could tax the income that was distributed to the beneficiary.[30] The tax was imposed on the beneficiary and not on the trustee, and was limited in its application to what the beneficiary owned or controlled.

In cases where the tax was an *ad valorem* tax, the state was limited to taxing only the value of its resident's interest in the trust assets. If a trustee was a resident, the state could tax the resident trustee on the value of the assets in the trust, and if there were multiple trustees, each state where a trustee resided could tax the trustee's proportionate interest in the trust property.[31] A state could tax a resident beneficiary on the value of the beneficiary's equitable interest in the trust.[32] The state could not tax a beneficiary on the entire value of the trust assets because the beneficiary did not have legal and equitable title to the trust assets.[33] A state could not impose an *ad valorem* tax on a nonresident trustee even though the beneficiary was present in the state.[34]

Even if a beneficiary's presence in the state is sufficient to tax the trust as a resident trust, determining the income attributable to the state would be problematic. A beneficiary's interest may not be ascertainable or enforceable.[35] The beneficiary's interest may be a present interest or a future interest. The income could be accumulated for remaindermen, and the remaindermen may not be presently ascertainable. In cases where there are contingent beneficiaries entitled to discretionary distributions of income, it is difficult to say how much tax could be attributed to any one beneficiary.

Because a state can only enforce the payment of a tax imposed on nonresidents to the extent the state has ''just control'' over persons[36] and property within its borders,[37] some legislatures have developed other means to collect an otherwise unenforceable tax.[38] For example, California enforces its tax on trusts by imposing a throwback tax on California beneficiaries.[39] Congress taxes a foreign trust, over which it does not have jurisdiction, by imposing the tax on the settlor, through the grantor trust rules, or the beneficiaries, through the throwback rules.[40] Even when a foreign trust is obligated to pay U.S. tax, the IRS must usually locate assets within the United States to enforce a judgment against the foreign trust.[41] These devices simply emphasize the need for a state to have jurisdiction over the trustee.

Presence of Settlor

Asserting that the settlor's presence in the state justifies taxing a trust as a resident trust is difficult to justify under hundreds of years of trust common law. The settlor has no interest in the trust once the trust is created, or if the settlor has retained some minimal rights

turn.' '' *MeadWestvaco Corp. v. Illinois Dept. of Rev.*, 553 U.S. 16, 24-25 (2008) (quoting *ASARCO Inc. v. Idaho Tax Comn.*, 458 U.S. 307, 315 (1982) and *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940)).

[27] *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929).

[28] The test of constitutionality for a tax can depend on the type of tax. *Oklahoma Tax Comn. v. Jefferson Lines*, 514 U.S. 175, 189-90 (1995) (distinguishing between gross receipts tax and sales tax on same activity).

[29] *Guaranty Trust Co. v. Virginia*, 305 U.S. 19 (1938).

[30] *Id.*; *Maguire v. Trefry*, 253 U.S. 12 (1920).

[31] In *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947), a New York decedent's will was probated in New York and also filed in Rhode Island. Two testamentary trustees were issued letters of trusteeship in New York, but not in Rhode Island. One trustee resided in Rhode Island and the other resided in New York. The trustees held intangible personal property in trust for the benefit of a New York beneficiary. The trust property was held in New York and the Rhode Island trustee did not exercise his trust powers in Rhode Island. Newport, R.I., assessed a property tax against the resident trustee measured by the resident trustee's one-half of the value of the trust corpus. The U.S. Supreme Court, considering only the Due Process Clause of the Fourteenth Amendment, held that a state can tax intangibles held by a resident trustee.

[32] *Stewart v. Pennsylvania*, 312 U.S. 649 (1941), *aff'g Commonwealth v. Stewart*, 338 Pa. 9, 12 A.2d 444 (Pa. 1940).

[33] For example, in *Brooke v. Norfolk*, 277 U.S. 27, 28 (1928), the court held that a Virginia beneficiary entitled to income for life from a fund controlled and possessed by Maryland trustees (where the trust was created) could not be taxed on the fund's corpus by Virginia.

[34] *See Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929).

[35] Consider that a gift in trust does not qualify for the present interest exclusion under I.R.C. §2503(b). Assets placed in trust do not give the beneficiary immediate access to or control over the asset.

[36] A trustee submits personally to the jurisdiction of the courts of Virginia if the principal place of administration is in Virginia. Va. Code Ann. §64.2-711(A).

[37] *See Shaffer v. Carter*, 252 U.S. 37, 52 (1920).

[38] *See* Joseph W. Blackburn, *Grantor Trusts, Trust Throwback Rules, and Their Application – or Not – by the States*, 16 J. Multistate Taxn. 5 (August 2006). *See also Int'l Harvester Co. v. Wisconsin Dept. of Taxn.*, 322 U.S. 435 (1944).

[39] California imposes an income tax on trusts if a resident of California is a trustee or a noncontingent beneficiary. Cal. Rev. & Tax Code §17742. The trustee is required to file the return. Cal. Rev. & Tax Code §18505. California apparently recognizes the difficulty in forcing nonresident trustees to file a return and pay tax, so it also provides that if a nonresident trustee does not file, then California will tax the beneficiary on that income when the income is distributed to the beneficiary. Cal. Rev. & Tax Code §17745. California can clearly tax the beneficiary in this manner because the beneficiary is a resident. Its authority to force a nonresident trustee to pay a tax and file a return is questionable. If California were to enforce the tax, it would have to seek a judgment in California and then seek to have the nonresident state where the trustee is present enforce the judgment. California could only do this if it had jurisdiction over the trustee. Unless the trustee has minimum contacts with California, it appears California's judgment would not be enforceable. *See Hanson v. Denckla*, 357 U.S. 235 (1958).

[40] *See, e.g.*, I.R.C. §§679, 2801; *see also* H.R. Rep. No. 1337, 83d Cong. 2d Sess. 60-64 (1954).

[41] *See, e.g.*, *U.S. v. Harden*, 36 D.L.R. (2d) 602 (C.A. B.C. 1962), *aff'd*, 41 D.L.R. (2d) 721 (Sup. Ct. Can. 1963); *U.S. v. Omar, S.A. (First National City Bank)*, 210 F. Supp. 773 (S.D.N.Y. 1962), *rev'd sub nom.*, *U.S. v. First National City Bank*, 321 F.2d 14 (2d Cir. 1963), *reversal sustained en banc*, 325 F.2d 1020 (2d Cir. 1964), *rev'd*, 379 U.S. 378 (1965).

under the trust agreement, those rights are rarely sufficient to exercise control over trust investments, which generate the income being taxed, or to control the distribution of that income.[42] If a settlor has retained sufficient rights under the trust instrument, the trust will be treated as a grantor trust under federal law.[43] The trust income will be taxed to the settlor at the federal level, and at the state level in Virginia.[44] The federal grantor trust rules are broad enough to encompass most rights that a settlor could retain that might be argued to give Virginia sufficient nexus. Because Virginia already taxes the Virginia settlor of a grantor trust, as a practical matter, retained rights of a settlor should not be a factor.

A state may assert that it is entitled to protect the interests of a resident settlor. *Shaffer v. Heitner* suggests, however, that a state's desire to protect its interests is not alone sufficient to grant general jurisdiction.[45] In *Heitner*, the plaintiffs asserted that Delaware should have the right to assert jurisdiction over nonresident officers and directors of a corporation created in Delaware. The fact that Delaware law may have governed the duties of the officers and directors was insufficient to give Delaware jurisdiction.[46] The officers and directors had not ''purposefully availed'' themselves of the benefits and protections of Delaware law.[47] Similarly, a trustee's agreement to hold trust assets under terms created by a settlor should not give Virginia jurisdiction over the trustee, especially when a settlor generally does not have a right to enforce a trust after its creation.

It seems unlikely that a nonresident trustee can be said to have purposefully availed itself of the protections and benefits of a state because the trustee agreed with a settlor to hold property in trust. As discussed above,[48] only the trustee holds title to trust assets outside of Virginia, and the income belongs to the trustee. The settlor has no interest in the trust assets or rights in the trust. The settlor cannot enforce the terms of the trust. Even if the trust is revocable, the settlor's interests are subject to the trustee's discretion unless and until the power of revocation is actually exercised.[49] The state of the settlor's domicile cannot regulate the actions of a nonresident trustee. To the extent a trust could be analogized to a contract, the U.S. Supreme Court has rejected the notion that entering into a contract with a party in another state is sufficient to give that other state personal jurisdiction, unless there is another substantial connection to the state.[50]

Nonresident Trustee's Purposeful Availment

To determine whether the trustee has purposefully availed itself of the benefits and protections of the state, the courts ought to consider the actions taken by the trustee in its fiduciary capacity as trustee for that trust. This is because the issue is not whether the trustee's own income is subject to tax in the settlor's state, but whether the trust's income is subject to income tax in the settlor's state.[51]

A nonresident trustee's marketing and solicitation of business in the state should not give the state continuing jurisdiction over trust income.[52] If a trustee's personal actions are considered, professional trustees who market themselves could be disadvantaged. Settlors would be encouraged to use family members or friends. Rarely can it be said that a family member solicited the opportunity to serve as a trustee. A family member serves, often reluctantly, at the request of the settlor. If a trustee must ''purposefully avail'' itself of the opportunity in the taxing state, it would be difficult to say that a family member trustee has done so. Therefore, a trust with a family member or friend serving as a trustee would not be subject to tax while a trust administered by a professional trustee could be subject to tax. Moreover, it is unlikely that a nonresident trustee is selling the benefits of the settlor's resident state. Experience indicates that the nonresident trustee wants settlors to know how the benefits and protections of the nonresident trustee's state are preferable to those of the resident state. The trustee is attempting to lure the settlor into the nonresident trustee's state.

Commerce Clause Limits on State Taxation Authority

The Commerce Clause authorizes Congress to regulate commerce among the several states.[53] The Commerce Clause also prohibits certain state actions that in-

[42] Once the trust is created, a settlor has no legal relationship with the trustee or the beneficiaries. *See* Amy Morris Hess et al., *Bogert Trusts & Trustees* §42 (3rd ed. 2007), and see cases cited in footnote 3.

[43] I.R.C. §671 *et seq.*

[44] Va. Code Ann. §58.1-322(A).

[45] *Shaffer v. Heitner*, 433 U.S. 186, 213-216 (1977).

[46] *Cf. Travelers Health Assn. v. Virginia*, 339 U.S. 643 (1950) (acknowledging Virginia's authority to regulate an out-of-state insurer).

[47] *Shaffer v. Heitner*, 433 U.S. 186, 216 (1977).

[48] *See* footnotes 7-17 and accompanying text.

[49] *Continental Bank & Trust Co. v. Country Club Mobile Estates*, 632 P.2d 869 (Utah 1981).

[50] *Helicopteros Nacionales De Colombia v. Hall*, 466 U.S. 408 (1984); *see also* Pamela J. Stephens, *The Single Contract as Minimum Contacts: Justice Brennan ''Has It His Way,''*, 28 Wm. & Mary L. Rev. 89 (1986), http://scholarship.law.wm.edu/wmlr/vol28/iss1/3. *But see McGee v. Int'l Life Ins. Co.*, 355 U.S. 220 (1957) (finding contract of insurance sufficient for due process in cause of action arising out of the contract).

[51] This issue may be especially important if a bank or other entity structured with offices in multiple states serves as a trustee.

[52] *Compare with*, *J. McIntyre Mach. Ltd. v. Nicastro*, 131 S. Ct. 2780 (2011), where the U.S. Supreme Court, in a plurality opinion, ruled that New Jersey did not have jurisdiction in a products liability case because the defendant corporation, created and based in the United Kingdom, had not engaged in conduct purposefully directed at New Jersey. The corporation had marketed generally in the U.S. market and corporation officials attended trade shows in several states, but not in New Jersey. Four machines ended up in New Jersey, one of which injured the plaintiff. The corporation did not have an office in the state, did not pay taxes or own property there and did not advertise in or send employees there. The U.S. Supreme Court concluded that the corporation had not purposefully availed itself of the New Jersey market. Unless the defendant availed itself of the privilege of conducting activities within the forum state, thus invoking the benefits and protections of its laws, there was no jurisdiction.

[53] *See Quill Corp. v. North Dakota*, 504 U.S. 298, 309 (1992). Congress has authority to regulate interstate commerce and may authorize state actions that burden interstate commerce, but does not have the power to authorize Due Process Clause violations. *See id.* at 305.

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terfere with interstate commerce. This is known as the "negative" or "dormant" Commerce Clause.[54]

A tax must pass the four-part test under *Complete Auto Transit Inc., v. Brady*, 430 U.S. 274 (1977), to be constitutional.[55] That test permits a tax so long as the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State."[56] The "substantial nexus" required under the Commerce Clause is not the same as the connection required under the Due Process Clause.[57]

A tax violates the Commerce Clause if a taxpayer would be subject to tax in more than one state on the same income.[58] A state cannot reach beyond its jurisdiction to tax value that is fairly attributable to economic activity outside the taxing state.[59] The courts will look at the practical, rather than the theoretical, effect of the statute.[60]

Virginia's taxation of resident trusts with multistate contacts likely does not meet the requirements of the *Complete Auto* test. Virginia defines a resident trust so broadly that a Virginia resident trust could be a resident trust in another state. In addition, Virginia does not give a tax credit for taxes paid to other states on income that is unearned or that is not related to a Virginia business.[61] Another state could tax the same income. When the trustee is not a resident, the investment activity occurs outside of the state. Virginia seeks to tax all of the trust income even though it exceeds the economic activity attributable to Virginia and is not fairly related to the services provided by the state.[62] For these reasons, Virginia's definition of a resident trust and its failure to prevent multiple taxation of trust income appears to violate the dormant Commerce Clause.[63]

Cases Should Still Be Decided Pursuant to *Safe Deposit*

The seminal case considering a state's constitutional authority to tax a trust is *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929). This case emphasizes that a state must have jurisdiction over the trustee to tax the trust property held by the trustee.

In *Safe Deposit*, the settlor, domiciled in Virginia, created a revocable trust for the benefit of his two minor sons, who also resided in Virginia. The trustee of the trust was in Maryland. The settlor transferred securities to the trustee. The trustee was to hold the securities in trust until the sons reached 25 years of age. The settlor died three months after the trust was created. After the settlor's death, Virginia imposed an *ad valorem* tax on the whole trust corpus.[64] The trustee appealed to the Virginia courts, and the Virginia Supreme Court eventually upheld the tax.[65]

At the Virginia Supreme Court, the trustee had argued that a state could only tax property within its jurisdiction and that Virginia lacked jurisdiction to tax the entire value of trust assets owned by a trustee outside of Virginia.[66] The Virginia Supreme Court had reasoned that the settlor was the owner of the trust because the trust was revocable during the owner's life.[67] After the settlor's death, the court had said that ownership passed to the settlor's administrator in Virginia and the beneficiaries. Relying on the doctrine of *mobilia sequuntur personam*, which says that intangible assets have a situs at the domicile of the owner, the Virginia Supreme Court had held that the trust assets, which were intangibles, had a situs where the beneficiary owners resided in Virginia.[68] It stated, "[t]he court is of opinion that no non-residents are owners or have any interest in the corpus of the trust fund in [Maryland]; that the present, and if essential, the ultimate owners of the property are residents of the State of Virginia."[69]

On appeal to the U.S. Supreme Court, the case hinged on ownership of the trust corpus. The court first noted that legal title was in the trustee. The beneficia-

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[54] *See id.* at 309.

[55] *MeadWestvaco Corp. v. Illinois Dept. of Rev.*, 553 U.S. 16, 24 (2008); *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

[56] *Complete Auto Transit Inc., v. Brady*, 430 U.S. 274 (1977).

[57] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[58] *See Oklahoma Tax Comn. v. Jefferson Lines*, 514 U.S. 175, 185 (1995) (clarifying that a tax is internally inconsistent if multiple taxation would result if every state were to impose an identical tax). Unlike the Commerce Clause, due process is not violated by multiple taxation, nor is it violated when different states separately determine that an individual is domiciled within the state. *See Curry v. McCanless*, 307 U.S. 357 (1939). *See also Worcester County Trust Co. v. Riley*, 302 U.S. 292 (1937). In *Worcester*, the U.S. Supreme Court held that the Constitution did not prohibit California courts from making a factual finding of a decedent's domicile, even though that finding could conflict with a contrary and inconsistent finding of a Massachusetts court. The U.S. Supreme Court pointed out that there were no inconsistent statutes at issue. If there had been inconsistent statutes, perhaps the result would have been different.

[59] *See Oklahoma Tax Comn. v. Jefferson Lines*, 514 U.S. 175 (1995) (examining the second prong of the *Complete Auto* test regarding fair apportionment of tax, discussing the meanings of "internally consistent" and "externally consistent" taxation).

Complete Auto's fourth criterion asks only that the measure of the tax be reasonably related to the taxpayer's presence or activities in the state.*Oklahoma Tax Comn. v. Jefferson Lines*, 514 U.S. 175, 200 (1995).

[60] *Id.* at 183.

[61] Va. Code Ann. §58.1-332(A).

[62] To the extent the nonresident trustee has property located within the jurisdiction of the settlor's residence, it can be subject to taxation as source income, but taxing income on property not within the jurisdiction of the settlor's residence is not within the "just control" of that state. It is "unfair" for a settlor's state to tax trust income that has no connection to the state other than the fact that the settlor was living in the state.

[63] *Cf. Hellerstein & Hellerstein, State Taxation* ¶ 20.09[2][b] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2013) (online version accessed on Checkpoint (www.checkpoint.riag.com) Oct. 31, 2013)).

[64] *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 90 (1929).

[65] *Trust Co. v. Commonwealth*, 151 Va. 883, 911 (Va. 1928) (decided March 1, 1928) (rehearing on Oct. 30, 1928).

[66] *Trust Co. v. Commonwealth*, 141 S.E. 825, 829, 151 Va. 883, 902 (Va. 1928) (decided March 1, 1928) (rehearing on Oct. 30, 1928), *rev'd*, *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929) (argument of counsel).

[67] *See Trust Co. v. Commonwealth*, 141 S.E. 825, 827, 151 Va. 883, 893-94 (Va. 1928) (decided March 1, 1928).

[68] *Trust Co. v. Commonwealth*, 141 S.E. 825, 151 Va. 883, 911 (1928) (rehearing Oct. 31, 1928).

[69] *Id.*

ries had no power over the trust corpus.[70] The court said that it was not required to make any inquiry into the ultimate or equitable ownership of the trust assets held by the beneficiaries.[71] The tax was not based on the value of the beneficiaries' interest in the corpus. The court confirmed that the power of Virginia to tax a resident (or in other words, the equitable interests of the beneficiaries) was not under consideration in this case.[72] The court emphasized that a state statute that seeks to tax something ''wholly beyond her jurisdiction or control conflicts with the Fourteenth Amendment.''[73] The Supreme Court then framed the issue as whether ''intangibles – stocks, bonds – in the hands of the holder of the legal title with definite taxable situs at its residence, not subject to change by the equitable owner, may be taxed at the [beneficiary's] domicile in another State.''[74] The court cited cases that considered whether a state had jurisdiction to tax tangible personal property.[75] The court held that Virginia could not tax trust assets held by a Maryland trustee for the benefit of beneficiaries residing in Virginia under a trust created by a Virginia domiciliary.

Some commentators have suggested that *Safe Deposit* is no longer good law.[76] Others have noted that it has not been overruled[77] and that it remains the law.[78] Those suggesting that *Safe Deposit* is no longer good law argue that the court's opinion rested on the view that multiple taxation was not permitted under the Due Process Clause. That view, they say, was later repudiated in *Guaranty Trust Company v. Virginia*, 305 U.S. 19 (1948) and in *Curry v. McCanless*, 307 US 357 (1939).[79] These cases do not necessarily overrule *Safe Deposit*.

In *Curry v. McCanless*,[80] a Tennessee settlor had created a trust with an Alabama trustee. The Tennessee settlor had reserved a power to appoint the trust assets at her death. She exercised the power of appointment. At her death, both Tennessee and Alabama asserted the right to impose a transfer tax on the trust assets. The settlor's estate wanted to know whether Tennessee or Alabama could tax the trust assets. A divided Supreme Court held that both Tennessee and Alabama could impose their transfer taxes.[81] The court reasoned that a state can tax the interests of persons within its jurisdiction. Alabama could tax the trustee as legal title holder.[82] Tennessee could tax the property because the settlor, having a general power of appointment, had control over the trust assets.[83] The court explained that it was ''accepted law'' that the state of the domicile of the donor and donee of a general power of appointment could tax trust assets held in trust in another state.[84] The person being taxed, the trust settlor, and the trustee each had legal title. The court noted that ''legal ownership'' of the assets was in two states.[85] It said, ''the testatrix brought some of the legal interests which she created within the control of one state by selecting a trustee there and others within the control of the other state by making her domicile there.''[86]

Curry did reject the idea that intangible personal property could have only one situs.[87] However, the court's concern with multiple taxation in *Safe Deposit* was simply an additional reason for not upholding the tax. The court rejected the tax in *Safe Deposit* because the tax was imposed on property that the beneficiary did not own. Twelve years after *Safe Deposit* the court clarified the opinion. In *Stewart v. Pennsylvania*,[88] the U.S. Supreme Court upheld a Pennsylvania tax on a beneficiary's equitable interest in a trust. The trust was created by a New York settlor with a New York trustee. The life beneficiary was in Pennsylvania. The trust securities had a value of almost $1.9 million. The life beneficiary's equitable interest was valued at 53.9 percent of the market value of the securities. Pennsylvania levied a tax, payable by the beneficiary, on the equitable interest. The Pennsylvania Supreme Court had made clear that the tax was on the beneficiary's equitable interest only.[89] After *Stewart*, it is clear that the tax in *Safe Deposit* would have been upheld had the tax been imposed on the beneficiary, rather than the trustee, and had it been determined on the value of the beneficiary's equitable interest rather than on the value of the entire trust corpus held by the nonresident trustee.

Further, *Curry* did not consider the differences between a trustee's legal ownership and the interests of a beneficiary or a settlor in the trust. A state can only tax the property interest of the person within the state's jurisdiction. *Safe Deposit* considered who had legal title and thus control over the asset. In *Curry*, taxation was permitted when the taxpayer had control over out-of-

[70] *Id.*

[71] *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 92 (1929).

[72] *Id.*

[73] *Id.*

[74] *Id.* at 93.

[75] *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 93 (1929) (relying on its reasoning in *Frick v. Pennsylvania*, 268 U.S. 473 (1925), and *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194 (1905).

[76] *See, e.g.*, *Hellerstein & Hellerstein, State Taxation* ¶¶ 20.04[1][a], 20.09[2][b] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2013) (online version accessed on Checkpoint (www.checkpoint.riag.com) Oct. 31, 2013)).

[77] *See, e.g.*, *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 15 N.Y.2d 579, 581 (N.Y. 1964). For additional insight, *see* Joseph W. Blackburn, *Constitutional Limits on State Taxation of a Nonresident Trustee: Gavin Misinterprets and Misapplies Both Quill and McCulloch*, 76 Miss. L.J. 1 (2006); Jordan M. Goodman, *State Taxation of Business Trusts: Limits, Concerns, and Opportunities*, 9 J. Multistate Taxn. 10 (February 2000).

[78] Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts*, 32 U. Rich. L. Rev. 165, 182-84 (1998).

[79] *See, e.g.*, *Hellerstein & Hellerstein, State Taxation*, ¶ 20.04[1][a] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2013) (online version accessed on Checkpoint (www.checkpoint.riag.com) Oct. 31, 2013)).

[80] *Curry v. McCanless*, 307 U.S. 357 (1939).

[81] *Id.* at 374.

[82] *Id.* at 370.

[83] *Id.* at 371-73.

[84] *Id.* at 372 (citing *Bullen v. Wisconsin*, 240 U.S. 625 (1920)).

[85] *Id.* at 372.

[86] *Id.* at 372.

[87] *Hanson v. Denckla*, 357 U.S. 235, 246-47 (1958) (citing *Curry v. McCanless*, 307 U.S. 357 (1939)). In *Safe Deposit*, the court had opined that intangible assets could not have situs within two different states at the same time. *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 94 (1929).

[88] *Stewart v. Pennsylvania*, 312 U.S. 649 (1941), *aff'g Commonwealth v. Stewart*, 338 Pa. 9 (Pa. 1940).

[89] *Commonwealth v. Stewart*, 338 Pa. 9, 20 (Pa. 1940).

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state assets by way of a power of appointment. When a beneficiary or settlor has no control over the investment of trust assets and distribution of trust income, there is no Supreme Court precedent that suggests a state has power to tax that income when it is earned and retained by a nonresident trustee.

When a beneficiary or settlor has no control over the investment of trust assets and distribution of trust income, there is no Supreme Court precedent that suggests a state has power to tax that income when it is earned and retained by a nonresident trustee.

Similarly *Guaranty Trust Co. v. Virginia*, 305 U.S. 19 (1938), addressed an issue that was not addressed in *Safe Deposit*. In *Guaranty* the court allowed two states, the state of the trustee's residence and the state of the beneficiary's residence, to tax the same trust income (i.e., the income at the trust level before distribution and then at the beneficiary level when distributed). In that case, a New York trustee had discretion to pay income to the beneficiary, a resident of Virginia. New York taxed all of the trust's income, including the income distributed to the beneficiary. (In other words, there was no distribution deduction.) Virginia then taxed the income distributed to the beneficiary residing in Virginia. The Supreme Court determined there was no denial of due process and upheld Virginia's right to tax the income distributed to the beneficiary, even though New York had taxed the same income before distribution. The state where the trustee resided could tax all of the income and the state where the beneficiary resided could tax the income received by the beneficiary. The tax on the income received by the beneficiary was upheld because it was a tax on a Virginia resident on income received by a Virginia resident. New York had taxed a separate taxpayer, the trustee, on the trustee's income.[90] Virginia had not attempted to tax the income held by the New York trustee.[91]

Even if the majority of the U.S. Supreme Court rejected the tax in *Safe Deposit* because it believed there was multiple taxation, the ultimate holding is still sound. As pointed out by Justice Harlan F. Stone in his concurrence, the court ultimately rejected Virginia's tax because the trustee was not present in Virginia. The threat of double taxation was not controlling in his view.[92] Justice Stone said ''the Virginia assessment was levied against a trustee domiciled in Maryland . . . and so is forbidden as an attempt to tax property without the jurisdiction.''[93] He concluded there was no threat of double taxation in *Safe Deposit* because the legal interests (the trustee's interest and the beneficiary's equitable interest) were not the same.[94]

New York's view is that *Safe Deposit* is still good law for the same reason given by Justice Stone. The New York court's brief opinion in *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 15 N.Y.2d 579, 581 (N.Y. 1964), follows:

> *Safe Deposit & Trust Co. v. Virginia* (280 U.S. 83) does not appear to have been overruled by *Guaranty Trust Co. v. Virginia* (305 U.S. 19) nor by *Graves v. Elliott* (307 U.S. 383),[95] in both of which property was taxed which was within or which was being distributed into the taxing State. The lack of power of New York State to tax in this instance stems not from the possibility of double taxation but from the inability of a State to levy taxes beyond its border. Instead of overruling *Safe Deposit & Trust Co. v. Virginia*, *Guaranty Trust Co. v. Virginia* recognized its authority by citing it and stating (305 U.S., at 23) that it went ''upon the theory that the taxing power of a state is restricted to her confines and may not be exercised in respect of subjects beyond them.'' This confirmed rather than refuted the determination in *Safe Deposit & Trust Co.* that the imposition of a tax in the State in which the beneficiaries of a trust reside, on securities in the possession of the trustee in another State, to the control or possession of which the beneficiaries have no present right, is in violation of the Fourteenth Amendment.

In contrast to *Safe Deposit's* holding that a state does not have jurisdiction over a nonresident trustee, the Virginia Tax Commissioner asserts that Virginia has general jurisdiction over a nonresident trustee. The commissioner's position is that any trust created by a Virginia domiciliary will be a Virginia resident trust if a beneficiary, trust asset or trustee is in Virginia.[96] If there are no Virginia beneficiaries, trust assets or trustees, then the trust will lose its Virginia nexus,[97] but the commissioner asserts that the trust will technically remain a Virginia resident trust and that Virginia's right to tax the trust as a resident will resurrect if a beneficiary, trustee or trust assets later are present in Virginia.[98]

By taking the position that a nonresident trustee can be subject to tax in Virginia based on the presence of a

[90] *Ryan v. Commonwealth*, 193 S.E. 534, 538, 169 Va. 414, 423 (Va. 1937), *aff'd by Guaranty Trust Co. v. Virginia*, 305 U.S. 19 (1938).

[91] *See also Stewart v. Pennsylvania*, 312 U.S. 649 (1941), *aff'g Commonwealth v. Stewart*, 338 Pa. 9 (1940). A state can tax the interest of the individual over whom the state has jurisdiction.

[92] *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 96 (1929) (Stone, J., concurring).

[93] *Id.* at 95.

[94] *Id.* at 96.

[95] In *Graves v. Elliott*, 307 U.S. 383 (1939), a Colorado resident created a revocable trust in Colorado. The resident then moved to New York where she died. Colorado imposed a tax on the transmission at death of the trust fund. New York also sought to impose an estate tax on the transfer of the trust. New York courts held that it could not tax property whose situs was outside the state. The Supreme Court reversed and held that New York could impose an estate tax on a domiciliary's relinquishment at death of a power to revoke a trust.

[96] Va. Dept. of Taxn., Virginia Ruling of the Commissioner PD 93-189 (Aug. 26, 1993).

[97] The rulings of the Virginia Tax Commissioner do not discuss the differences between the nexus required under the Due Process Clause and the nexus required under the Commerce Clause.

[98] *See* Va. Dept. of Taxn., Virginia Ruling of the Commissioner PD 93-189 (Aug. 26, 1993).

trust beneficiary in Virginia, Virginia is essentially asserting that *Safe Deposit* is no longer good law. That proposition is questionable. Moreover, taxpayers have the right to continue to rely on *Safe Deposit* as good law unless the Supreme Court specifically overturns it. Justice Antonin Scalia has said that ''if a precedent of [the Supreme Court] has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to [the Supreme Court] the prerogative of overruling its own decisions.''[99]

Taxpayers have the right to continue to rely on *Safe Deposit* as good law unless the Supreme Court specifically overturns it.

State Cases Grapple With Lack of Recent Supreme Court Guidance

State Case Law

Most state cases decided prior to the U.S. Supreme Court's 1992 decision in *Quill Corp. v. North Dakota*,[100] which held that the requirements of the Due Process Clause and the Commerce Clause were not identical,[101] had determined that the state had violated due process when it taxed a trust that had nonresident trustees.[102] After *Quill*, in the late 1990's, two jurisdictions, the District of Columbia and Connecticut, separately determined that a trustee's presence in the state was not required when the state, or the District, sought to tax a testamentary trust.[103] Commentators questioned the result in those cases,[104] but it was not until 2013 that courts again reconsidered the issue. These courts did not follow the District of Columbia or Connecticut decisions, but they are also not decisions of the highest court of the state. These courts confirmed that a trust with a nonresident trustee could not be taxed as a resident trust.

Chase Manhattan Cases

In *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. 1997), the District of Columbia Court of Appeals considered whether the Due Process Clause prohibits the District of Columbia from taxing a trust created under the will of an individual who died

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[99] *Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992) (Scalia, J., concur) (citing *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989)).

[100] *Quill Corp v. North Dakota*, 504 U.S. 298 (1992).

[101] The court considered whether a corporation doing a mail order business with no physical presence in North Dakota had sufficient nexus with North Dakota for North Dakota to require the corporation to serve as a collection agent for a use tax imposed on its North Dakota customers, but the corporation did not have nexus under the Commerce Clause. There is a three part test under *Quill*: (1) Did the taxpayer purposefully direct its activities at residents of the state, (2) were the magnitude of those contacts sufficient for due process purposes, and (3) is the tax related to the benefits the taxpayer receives from access to the state? *Quill*, 504 U.S. at 308.

[102] In 1964, the Court of Appeals of New York in *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 15 N.Y.2d 579, 581 (N.Y. 1964), determined that New York could not tax a trust created by a New York domiciliary when the trustee was located in Maryland, even when the trust beneficiaries were located in New York. In contrast, in that same year, in *McCulloch v. Franchise Tax Board*, 61 Cal. 2d 186 (Cal. 1964), the California Supreme Court held that due process did not prohibit the state from subjecting a trust controlled by trustees in another state to tax when its beneficiary was a California resident. California enforced the tax by requiring the beneficiary, under transferee liability, to pay the tax not paid by the trust when the beneficiary received the previously undistributed trust income. In 1983, in *Potter v. New Jersey Taxn. Div. Dir.*, 5 N.J. Tax 399 (N.J. Tax Ct. 1983) and in *Pennoyer v. New Jersey Taxn. Div. Dir.*, 5 N.J. Tax 386 (N.J. Tax Ct. 1983), the New Jersey Tax Court denied the state's right to tax a testamentary trust and an *inter vivos* trust created by New Jersey settlors but administered by trustees located outside of the state. It did not matter that there were New Jersey beneficiaries who had contingent rights to trust income. In 1987, in *In re Swift*, 727 S.W.2d 880 (Mo. 1987), the Missouri Supreme Court considered whether Missouri could tax the income of testamentary trusts created by the will of a Missouri domiciliary when the trust property, administration and beneficiaries were all outside of the state. The Missouri statute defined a resident trust to include a trust created by will of a decedent who at his death was domiciled in Missouri. The court said it must consider six points of contact: (1) the domicile of the settlor; (2) the state where the trust is created; (3) the location of the trust property; (4) the domicile of the beneficiaries; (5) the domicile of the trustees; and (6) the location of the administration of the trust. In this case, only the first two factors were present. The court stated that due process required that Missouri offer a present benefit or protection to the trusts, the beneficiaries, trustees or property and that Missouri did not offer any current protection or benefit. The trusts were not subject to tax in Missouri. In *Westfall v. Missouri Dir. of Rev.*, 812 S.W.2d 513 (Mo. 1991), a divided Missouri Supreme Court held that a trust created under the will of a Missouri domiciliary was subject to tax as a Missouri resident trust even though the trustee was not present in Missouri. The trust had sufficient nexus because it owned real estate in Missouri and because some charities, under certain contingencies, could receive distributions. In *Blue v. Michigan Dept. of Treas.*, 185 Mich. App. 406 (Mich. Ct. App. 1990), Michigan sought to tax a trust as a Michigan resident trust because the trust became irrevocable while the settlor was a Michigan resident. The trust was administered in Florida and the income beneficiary was in Florida. The only trust property in Michigan was non-income producing real estate. The court held that Michigan could not impose its tax.

[103] *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539, 544 (D.C. 1997); *Chase Manhattan Bank v. Comr. of Rev. Servs.*, 45 Conn. Supp. 368 (Conn. Super. Ct. 1997), *aff'd by Chase Manhattan Bank v. Gavin*, 249 Conn. 172 (Conn. 1999).

[104] *See, e.g.*, Joseph W. Blackburn, *Constitutional Limits on State Taxation of Nonresident Trustee: Gavin Misinterprets and Misapplies Both Quill and McCulloch*, 76 Miss. L. J. 1 (2006); *Hellerstein & Hellerstein, State Taxation*, ¶ 20.09[2][b] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2013) (online version accessed on Checkpoint (www.checkpoint.riag.com) Dec. 1, 2013). Gamewell Gantt and John McGown, Jr., *State Taxation of Trusts and Their Beneficiaries When There are Multiple State Contacts*, 20 J. St. Taxn. 1 (2001); Bernard E. Jacob, *An Extended Presence, Interstate Style: First Notes on a Theme from Saenz*, 30 Hofstra L. Rev. 1133 (2002); Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts*, 32 U. Rich. L. Rev. 165 (1998).

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domiciled in the District of Columbia when the trustee, trust assets and beneficiaries are all located outside of the jurisdiction. The settlor died in 1934 and the courts of the District of Columbia exercised continuing supervisory jurisdiction over the trust since its inception. The trust filed annual accountings until 1990 when the court disavowed any continuing supervision over the trust. The courts handled litigation in 1977 and in 1992 regarding beneficiary status. Otherwise, the trustee, the trust assets and the beneficiaries were all located outside of the District of Columbia. The court likened a testamentary trust to a domestic corporation. It reasoned that a domestic corporation is a creature of the law of the state in which it was created and stated that a testamentary trust similarly ''is a creature of the laws of the state where it is created and owes its very existence to those laws.''[105] The court noted that a testamentary trust remains at the testator's domicile, giving the domiciliary court *in rem* jurisdiction independent and apart from the presence of the trustee, the trust assets or the trust beneficiaries.[106] The court further emphasized that the District of Columbia always retained ''the principal, continuing jurisdiction'' over a testamentary trust, no matter the location of the trustee, the trust assets or the beneficiaries.[107] The court stated that the Supreme Court has equated a state's power to exercise jurisdiction over an entity with the state's power to tax that entity. Therefore, the court concluded that due process did not prohibit the District of Columbia from taxing the trust. The court did not address whether the Commerce Clause was violated.

In *Chase Manhattan Bank v. Gavin*, 249 Conn. 172 (Conn. 1999), the Connecticut Supreme Court held that five trusts were subject to income tax in Connecticut.[108] Four were testamentary trusts, one was an *inter vivos* trust, and all were created in Connecticut by Connecticut residents. The testamentary trusts filed either periodic or terminating accounts under Connecticut law. None of the trusts had Connecticut trustees or trust assets in Connecticut. None had trust income derived from Connecticut sources.

Recent Case Law

Pennsylvania

In *Bernstein v. Stiller*,[109] the Eastern District of Pennsylvania held that it lacked personal jurisdiction over nonresident trustees. The trusts were created by a Pennsylvania domiciliary in Maryland, and the assets were held in Maryland. The settlor's husband, a Pennsylvania resident, was a co-trustee prior to his death in 2007. The other co-trustees were nonresidents. The plaintiffs argued, *inter alia*, that the trusts were Pennsylvania resident trusts for income tax purposes. The court held that Pennsylvania's jurisdiction to tax the trusts ended with the death of the Pennsylvania resident trustee.[110] The court stated, ''Because there are insufficient minimum connections to support Pennsylvania's taxation of the trust assets, there are insufficient minimum contacts to support a claim of personal jurisdiction.''[111]

In *McNeil v. Commonwealth*, 67 A.3d 185 (Pa. Commw. Ct. 2013), Pennsylvania sought to tax all of the trust's income in 2007. The trust was created by a Pennsylvania settlor in 1959. The beneficiaries were residents of Pennsylvania. The beneficiaries' right to trust income and principal were discretionary. The administrative trustee, Wilmington Trust Company, only transacted trust business in Delaware. The other general trustees resided outside of Pennsylvania. The court held that Pennsylvania could not tax the trust because doing so violated the Commerce Clause. The court analyzed all four prongs of the *Complete Auto* test and found that all four prongs were violated. It noted that neither the creation of the trust by a Pennsylvania settlor nor the presence of discretionary beneficiaries in Pennsylvania established sufficient nexus under the Commerce Clause. It noted that Pennsylvania's attempt to tax all of the trust income, when none of that income was attributable to Pennsylvania sources, was not fairly apportioned and was out of all proportion to the trust's activities in Pennsylvania that generated payment of that income. Further, the court held that the trust did not benefit from the protections, opportunities and services of Pennsylvania, even though the beneficiaries did benefit and the settlor had benefitted before his death from the protections, opportunities and services of Pennsylvania. The court emphasized that neither the beneficiaries nor the settlor were the taxpayer in this case.

New Jersey

In *Residuary Trust A v. New Jersey Director, Division of Taxation*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013), the New Jersey Tax Court reaffirmed its prior case law holding that due process bars New Jersey from taxing the undistributed income of a trust if the trustee, assets, and beneficiaries are located outside of New Jersey. The court noted that the availability of the New Jersey courts to enforce or interpret the trust is an insufficient contact with New Jersey to support an income tax assessment.[112]

Illinois

In *Linn v. Illinois Department of Revenue*, 2 N.E.3d 1203 (Ill. App. Ct. 2013), an Illinois appellate court held that an *inter vivos* irrevocable trust created by an Illinois settlor could not be taxed by Illinois when the trustees, beneficiaries and the trust protector were not Illinois residents. To do so would violate the due process clause.

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[105] *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539, 544 (D.C. 1997).

[106] *Id.*

[107] *Id.*

[108] *See Chase Manhattan Bank v. Comr. of Rev. Servs.*, 45 Conn. Supp. 368 (Conn. Super. Ct. 1997).

[109] *Bernstein v. Stiller*, 2013 BL 172426, No. 09-659 (E.D. Pa. June 27, 2013).

[110] *Id.*

[111] *Id.*

[112] New Jersey also argued that it had nexus because the trust owned shares in S corporations that conducted some business in New Jersey. The court refused to attribute to the trust the S corporation's assets in New Jersey. The S corporations' ownership of assets in New Jersey did not create the requisite nexus to subject the trust to tax on its undistributed non-New Jersey income. The trust was only required to pay tax on the S corporation income attributable to New Jersey sources.

Reconciliation of Recent State Cases

Arguably the *Chase Manhattan* cases are rooted in a failure to recognize and respect the nature of a trust, as discussed above. As has been ably discussed in other articles, the courts' reasoning in those cases is questionable.[113] However, as to the testamentary trusts, there may be a reasonable basis for the courts' decisions with respect to the due process concerns (but not the Commerce Clause issues) in those cases.

Some jurisdictions, like Connecticut, the District of Columbia and Virginia, exercise more control over a testamentary trust than an *inter vivos* trust because they view the trust as a continuation of the probate of the will under which the trust was established.[114] Other states do not distinguish between testamentary and *inter vivos* trusts.[115] The Virginia statute defines a resident trust to include a trust that was created by the will of a Virginia domiciliary. It also includes an *inter vivos* trust that was created by a Virginia domiciliary. As discussed above, a settlor's presence in the state is an insufficient basis for state jurisdiction over a nonresident trustee, whether or not the trust is *inter vivos* or testamentary. Nevertheless, a testamentary trust created by a resident could be taxable in the state if the trust is administered in the state.

The Virginia Administrative Code states that a trust administered in Virginia includes a trust that is under court supervision.[116] In Virginia, an *inter vivos* trust is not subject to continuing judicial supervision unless ordered by a court.[117] An *inter vivos* trust's creation and oversight are not usually tied to the decedent's domiciliary state.[118] A testamentary trust may be subject to the continuing oversight of a Virginia court.[119] A testamentary trustee may or may not be required to file annual accountings before a commissioner of accounts.[120] At the very least, a testamentary trustee's appointment and removal remain subject to court control.[121] Even though a nonresident trustee may serve, Virginia retains the right to oversee and regulate the actions of the trustee.[122]

The authority to regulate the actions of a testamentary trustee may be sufficient to give Virginia constitutional authority to tax a testamentary trust and to deem the principal place of administration as being in Virginia.[123] In the *Chase Manhattan Bank* cases,[124] the Connecticut and the District of Columbia courts emphasized the oversight that the courts play in administering a testamentary trust.[125] In Connecticut, the testamentary trust was required to file a final accounting even if it did not have to file interim annual accountings.[126] In the District of Columbia, the testamentary trust was required to file annual accountings and the courts retained primary jurisdiction over the trust under state law.[127]

Therefore, if Virginia taxes a testamentary trust with nonresident trustees, it is properly taxing the trust only because it is administered in Virginia under court supervision and not because it was created by a Virginia domiciliary. There seems to be no justification to tax a trust with nonresident trustees, unless the trust is a testamentary trust administered in Virginia and the trustee is required to file accountings and is subject to continuing judicial oversight.[128]

Even if a state, like Virginia or Connecticut, has sufficient contacts with a nonresident trustee under the Due Process Clause to tax the trustee, the state is still not permitted under the Commerce Clause to tax more than the state's proportionate share of the income attributable to that state. A nonresident trustee actually administers the trust outside of the state. The state

[113] *See, e.g.,* Joseph W. Blackburn, *Constitutional Limits on State Taxation of Nonresident Trustee: Gavin Misinterprets and Misapplies Both Quill and McCulloch*, 76 Miss. L. J. 1 (2006).

[114] *See* Va. Code Ann. §64.2-700. *See also, e.g., District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. 1997), Chase Manhattan Bank v. Gavin, 249 Conn. 172 (Conn. 1999).

[115] *See Residuary Trust A v. New Jersey Dir., Div. of Taxn.*, 27 N.J. Tax 68, 75-76 (N.J. Tax Ct. 2013) (noting that court supervision of a testamentary trust in New Jersey is discretionary and limited).

[116] *See* Va. Regs. §10-115-10.

[117] Va. Code Ann. §64.2-710(B).

[118] In some cases, an *inter vivos* trust may become subject to court oversight. *See, e.g., In re Peierls Family Testamentary Trusts*, 77 A.3d 249 (Del. 2013).

[119] Va. Code Ann. §§64.2-706(F); 64.2-700(A).

[120] Va. Code Ann. §§64.2-1300(C); 64.2-1306; 64.2-1307. A testator or the beneficiaries can waive the requirement to file accountings. Va. Code Ann. §64.2-1307.

[121] Va. Code Ann. §64.2-1401(B). The exclusive jurisdiction for appointment of a testamentary trustee is in the court where the will was admitted to probate. Va. Code Ann. §§64.2-1401(A); 64.2-710(B) (noting exception to continued judicial supervision for certain trusts).

[122] Va. Code Ann. §64.2-1426.

[123] *But see* Joseph W. Blackburn, *Constitutional Limits on State Taxation of Nonresident Trustee: Gavin Misinterprets and Misapplies Both Quill and McCulloch*, 76 Miss. L. J. 1 (2006).

[124] *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. 1997), *Chase Manhattan Bank v. Gavin*, 249 Conn. 172 (Conn. 1999), *Chase Manhattan Bank v. Comr. of Rev. Servs.*, 45 Conn. Supp. 368 (Conn. Super. Ct. 1997).

[125] These courts did not consider *Shaffer v. Heitner*. In *Heitner* the plaintiff had argued that the defendants' positions as directors and officers of a Delaware corporation were sufficient contacts to give Delaware jurisdiction over the defendants. The plaintiff argued that Delaware had a strong interest in supervising the management of the Delaware corporation. However, the court pointed out that Delaware asserted jurisdiction based on the defendant's property interest, and not based on the need to oversee directors of a Delaware corporation. *Shaffer v. Heitner*, 433 U.S. 186, 214-15 (1977). Even if Delaware had asserted jurisdiction based on its desire to oversee directors of a Delaware corporation, the Supreme Court said it was still not a fair forum for the litigation. The interests of Delaware the plaintiff had identified supported the application of Delaware law to resolve any controversy over the defendants' actions in their capacities as officers and directors, but the application of a state's law, however, was not sufficient to grant jurisdiction. *Id.* at 215. The issue, the court said, was jurisdiction, not choice of law.

[126] *Chase Manhattan Bank v. Comr. of Rev. Servs.*, 45 Conn. Supp. 368, 371 (Conn. Super. Ct. 1997).

[127] *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. 1997).

[128] It may be possible for two states to determine that the principal place of administration is within its own state. This may occur, for instance, in the case of a testamentary trust that is administered by a nonresident trustee. The Supreme Court has allowed two states each to find that an individual was domiciled in its state. *See Worcester County Trust Co. v. Riley*, 302 U.S. 292 (1937). The states imposing the tax would still need to avoid double taxation under the Commerce Clause.

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where the nonresident trustee is present would have a right to tax the trust as well. What proportion of income each state may tax under the Commerce Clause remains unclear. The simplest solution is to allow the state where the principal place of administration[129] is located to tax the trust as a resident trust. All other states could tax source income.[130]

The simplest solution is to allow the state where the principal place of administration is located to tax the trust as a resident trust. All other states could tax source income.

Conclusion

Statutes in more than half of the states, including Virginia, could be interpreted to impose a tax on a trust that has no resident trustee.[131] These states assert that a trust is an entity or that a nonresident trustee has a relationship, or minimum contacts, with the state through the presence in the state of the settlor, the beneficiaries or trust assets.[132] Asserting nexus with a nonresident trustee by way of a resident settlor, beneficiary or trust assets is not consistent with U.S. Supreme Court precedent or with general trust law.

The Supreme Court's decisions affecting court jurisdiction over trusts are best understood when one considers the separate rights and roles of the trustee, the beneficiary and the settlor. Each has distinct rights (or a lack of rights), and the authority of a state to tax or otherwise assert jurisdiction depends on whether the beneficiary, trustee or settlor is present in the state and whether the interest to be taxed is owned or controlled by that resident. Supreme Court decisions consistently require that the person being taxed and the person's interest in the property being taxed correspond and that the state imposing the tax have jurisdiction over that taxpayer.

There is no doubt under the U.S. Constitution that Virginia can tax income arising from property or transactions that are in or occur within Virginia. There is also no doubt that Virginia can tax all of the income of persons who are within its borders for more than a temporary period. The difficulty lies in Virginia's defining a resident trust in a way that seeks to tax persons, property and transactions beyond Virginia's jurisdiction on income that is not Virginia-source income. It does this by defining a resident trust in a way that requires nonresident persons to pay tax on Virginia non-source income.

In some ways, the Virginia Tax Commissioner's rulings have reduced some of the far reaches of the Virginia statute. For example, the commissioner's rulings on when a trust is administered in Virginia have been reasonable and fair. However, conceding that the Virginia statute arguably permits it, the commissioner's stated intent to tax a trust created by a Virginia domiciliary when no trustee is present in Virginia is constitutionally suspect and leaves advisors and fiduciaries in a predicament. For example, if a Virginia settlor wants to create a trust with a Delaware trustee having the expectation that the trust assets will not be subject to state income tax in Virginia, must the trustee file a fiduciary return in Virginia? Based on statements in the Virginia Tax Commissioner's rulings,[133] the fiduciary would need to file returns in Virginia because the trust was created by a Virginia domiciliary. This position seems indefensible in light of general trust principles and Supreme Court precedent, yet Virginia and other states[134] persist in asserting it, and some state courts (although a minority) have upheld it.

Even if one were to assume that the U.S. Supreme Court would uphold the commissioner's position, a trustee is still entitled to rely on *Safe Deposit*[135] and other precedent requiring jurisdiction over the trustee itself.[136] Even though reliance on precedent may not carry the day, the court has advised parties not to anticipate an overruling of precedent by the Supreme Court.[137] The precedent clearly suggests that a state may tax a trust only if it has jurisdiction over a resident trustee. Further, as discussed above, the precedent is consistent with current jurisprudence, especially when one considers the legal underpinnings of a trust. Therefore, a prudent trustee should not blindly accept Virginia's, or another state's, assertion of authority to impose its tax on a nonresident trustee.

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[129] For both a testamentary trust and an *inter vivos* trust the principal place of administration would need to be where the trustee is located, and in cases of multiple trustees, where the trust records are maintained.

[130] Because a trust is more like an individual who by traditional is more of a passive investor, rather than a corporation or partnership that is actively pursuing a business, it would be preferable to treat the trust as an individual. Traditional apportionment of business income by way of property, payroll and sales factors would not be an appropriate measurement.

[131] *See* Richard W. Nenno, *Bases of State Income Taxation of Nongrantor Trusts*, http://www.actec.org/public/Documents/Studies/Nenno_state_nongrantor_tax_survey_06_04_13.pdf (June 4, 2013).

[132] *See, e.g.*, *In re Swift*, 727 S.W.2d 880 (Mo. 1987).

[133] Va. Dept. of Taxn., Virginia Ruling of the Commissioner PD 93-189 (Aug. 26, 1993) (stating that ''when a trust is created its classification [as a resident trust] can be determined by the domicile of the grantor.'') Va. Dept. of Taxn., Virginia Ruling of the Commissioner PD 99-168 (June 22, 1999) (stating the department of taxation will ''not impose fiduciary income tax on a resident trust in situations in which a Virginia grantor is deceased and no other party or trust property is located in Virginia [but if] any of the other parties or property is located in Virginia, fiduciary income tax will be imposed.'')

[134] In 2013, Florida amended its version of the Uniform Trust Code to assert personal jurisdiction over nonresident trustees when the settlor resided in Florida when the trust was created. Fla. Stat. §736.0202(2)(a)(3).

[135] *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929).

[136] *See Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477 (1989); *see also Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992) (Scalia, J., concur) (citing *Rodriguez de Quijas*).

[137] *Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992) (Scalia, J., concur).