

State Trust Taxation Still Pushing Due Process Limits


By **Maria Koklanaris**

Law360 (August 6, 2021, 6:49 PM EDT) -- An Oregon Supreme Court decision allowing the inclusion of Montana trust property in the state's estate tax valuation suggests continued testing of due process limits by states despite the U.S. Supreme Court's rejection of a similar North Carolina regime.



Oregon's highest court affirmed that the inclusion of Montana trust property in an estate doesn't violate federal due process because the deceased had an exclusive lifetime interest in the property and lived in Oregon. One attorney hopes the trust petitions the U.S. Supreme Court. (AP Photo/J. Scott Applewhite)

The Oregon Supreme Court **found July 29** that the U.S. Constitution's due process clause doesn't prevent Oregon from including in its estate tax measurement the value of a Montana trust property because the deceased had a lifetime interest in the property and lived in Oregon. That was enough of a connection, the court found, even though the deceased had no control over how the trust assets were invested, managed or distributed at her death.

And to argue its case, the Oregon Department of Revenue relied on the 2019 U.S. Supreme Court decision in [North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust](#) , which found for the trust. In that case, the U.S. Supreme Court held unanimously that North Carolina could not tax an out-of-state trust when the only connection between the state and trust was a beneficiary's residence in North Carolina.

The state of Oregon had claimed that while Kaestner showed there was not enough minimum contact when the beneficiary only lived in the state and did not take distributions from the trust, having the right to receive income from the trust and limited rights to take distributions does establish minimum contact. Oregon's justices agreed.

The Oregon case shows states will continue to encroach, Jenna R. Wolinetz of Cushing & Dolan PC told Law360. The U.S. Supreme Court last year declined to hear a Massachusetts case concerning \$1.8 million in tax on the unreported intangible assets of a trust, a case Wolinetz worked on, leaving a decision by the state's highest court standing. In the Massachusetts case, the **state justices found** that the state could tax the trust even though it was created by a deceased spouse when he was a legal resident of another state.

"Where the sole connection to the state is that the decedent passes away in the state while being an income beneficiary of the trust, we don't believe that under due process, that allows the state to tax the assets," as happened in Oregon, Wolinetz said. She said she hopes the trust petitions the U.S.

Supreme Court for a writ of certiorari.

"Maybe if these decisions keep getting appealed, the court will take it up," she said.

Like the Massachusetts case argued by Cushing & Dolan, the Oregon case involved a qualified terminable interest property trust, or QTIP trust, which allows married spouses to shift value between each other to defer paying taxes until both have died. Wolinetz said in both the Massachusetts and Oregon cases, the states successfully argued that receipt of income qualifies for minimum contact even if the trust is out-of-state and the beneficiary had no control.

"We definitely don't think that being an income beneficiary of a QTIP trust, for a QTIP election made in another state, creates a minimum connection for due process to apply," Wolinetz said.

Both sides in the Oregon case invoked *Kaestner*, **in which the trust won**. But in Oregon, the trust argued that *Kaestner* was not enough, and the state argued that *Kaestner's* rules, along with several other cases, showed that the deceased spouse in Oregon had enough connection to satisfy due process.

The Oregon justices agreed, saying the deceased spouse only had to have "some degree of possession or enjoyment of, or right to receive the trust property," and the spouse, whose name was Helene J. Evans, did that by being the income beneficiary, having an exclusive lifetime interest in the trust property and being in Oregon upon her death, among other factors. The justices also said they were not necessarily concluding that Evans had no control over the trust, either, but said they did not need to reach that question.

When comparing with *Kaestner*, the type of trust is highly relevant as well, noted Stuart Kohn, leader of the trusts and estates group at Levenfeld Pearlstein LLC.

"In *Kaestner*, the trust was completely discretionary. The beneficiary never received anything or could not receive anything if the trustee decided not to give them anything," Kohn said. "In this Oregon case, it was a marital trust," with the spouse having the right to receive assets, and having received income from the assets.

Still, "the connection to Oregon is a little bit tenuous here," said Michael Lurie, state tax associate with Reed Smith LLP. He noted that in addition to *Kaestner*, the Oregon justices cited cases including the 1940 *Whitney v. State Tax Commission of New York*, the 1939 *Curry v. McCanless* and the 1939 *Graves v. Elliott*.

"I think the court was right to say that under *Kaestner*, *Whitney*, *Curry*, *Graves*, all these long-standing due process cases, that [Oregon] can tax something here," Lurie said. "But I don't think this case is close enough to any of those."

Lurie said the above cases didn't involve the problem of the beneficiary of the life estate in one state, and the remainder beneficiaries in another state, and how taxation should be considered in that light.

"Here the court concluded that 100% of that trust can be taxed in Oregon," Lurie said. "I just don't see how they got to that result."

It would be interesting to see what a federal court would make of the case, said Richard Levine, special counsel in the private client and tax team at Withers LLP. Like Lurie, he said he thought a federal court could conclude that while Oregon could tax income from the trust, taxing the principal is a bridge too far.

"I sort of lean toward saying it was wrongly decided," Levine told Law360.

He said he is concerned that granting Oregon taxing authority here means that the trust is availing itself of Oregon.

"And if the trust really were availing itself of Oregon, then you could sue the trustee there," Levine said. "And I think most likely if you asked the U.S. Supreme Court whether they would say the trustee is amenable to suit in Oregon merely because the beneficiary lives there, I think they would

say no."

--Additional reporting by James Nani. Editing by Tim Ruel and Roy LeBlanc.

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