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Kaestner case creates fantastic precedent for trust beneficiaries

A unanimous U.S. Supreme Court ruling on June 19 has reinforced the advantages of keeping assets inside a trust for the protection of the ultimate beneficiaries versus the classic will-based strategy of outright distribution. While this case is based on some unique facts, it provides a great example of one way to use trusts.

Background

Joseph Lee Rice III created a trust in 1992 for his children. Rice was a New York resident and the trust was based on New York law. He was the trust-maker and the trustee of the trust. After his death, the successor trustee would have "absolute discretion" to distribute the assets to the beneficiaries.

When the trust was established, none of the beneficiaries happened to live in North Carolina (this is important to note). It wasn't until 1997, that his daughter Kimberly Rice Kaestner, moved to North Carolina and lived there until 2008.

The original trust was divided into three sub trusts sometime after Kimberly moved to North Carolina. One of the sub trusts was for the benefit of Kimberly and her three children, titled the Kimberly Rice Kaestner 1992 Family Trust. The terms of the original trust still applied regarding distributions. None of the assets were distributed to the beneficiary while living in North Carolina.

However, the North Carolina Department of Revenue took the position that since she was a beneficiary of the trust, she should be taxed on the income of the trust, regardless of the fact that she had not received it.

Kaestner received a tax bill on the trust's accumulative income from 2005 to 2008, which was the time for when she was a resident of North Carolina, pursuant to N.C. Gen. Stat. §105-160.2 (2017), that states any trust income that is for the benefit of a North Carolina resident may be taxed.

Kaestner did pay the tax bill, but did so under protest, challenging the assessment and requesting a refund for the tax on the grounds that it was a violation of the due process clause of the fourteenth amendment.

The Ruling

This summer, the High Court ruled that North Carolina couldn't tax the trust. None of the assets where distributed in the state of North Carolina, and the beneficiaries living in the state weren't enough of a connection, so they ruled in favor of Kaestner, saying that the trust had no contact with the state.

Plus, there were no distributions, no right to demand distributions, and no guarantee of distributions. In short, Kimberly could not get at the money if she wanted it, and neither could the state of North Carolina for tax purposes.

The Impact

Some professionals say that the impact may be limited in estate planning and trust taxation since the case was so fact-based. We think it's a great case showing that trust strategy works. There are so many advantages to trust planning over any other type of planning that it is confounding as to why it is not the go-to type of planning for everyone who wants to protect their loved ones.

As always, we hope this article is informative to you and your clients. If you have any concerns or suggestions, please contact our office. We're here to help.