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Limitations on a State Imposing an Estate Tax on a QTIP Trust Located in Another State Under the Due Process Clause

August 27, 2021

2021-6

A. Background

In recent years, three cases, one from Maryland, one from Massachusetts and one from Oregon, have essentially dealt with the same fact pattern; a spouse has died in one state having created a marital deduction QTIP trust for the surviving spouse and the surviving spouse moves to another state and then dies a resident of that state which asserts that it may impose an estate tax on the trust property. The cases were discussed in past issues of Practical Drafting. The most recent case is the Oregon Supreme Court decision in *Estate of Helene J. Evans v. Department of Revenue*, 368 Or 430 (2021), which is discussed in the next section below.

The first case was *Comptroller of the Treasury v. Taylor*, 238 Md. App. 139, 189 A.3d 799 (2018); 465 Md. 76, 213 A.3d 629 (2019). The case was discussed on pages 13426-13427 of Practical Drafting January 2019 and pages 13823-13827 of Practical Drafting January 2020. The issue involved an interpretation of Maryland tax law.

The second case was *M. Christine Shaffer*, *Executrix v. Comm'r of Revenue*, 485 Mass. 198 (2020). It was discussed on pages 13826-13832 of Practical Drafting January 2020. Both *Taylor* and *Shaffer* were discussed again on pages 14043-14062 of Practical Drafting October 2020. In *Shaffer*, the estate applied for *certiorari* from the United States Supreme Court based upon the Due Process Clause being violated. The application was rejected.

In all three cases, the decision was that an estate tax on the surviving spouse's estate, including the QTIP, was proper.

The third case was *Evans*, previously referred to. The Oregon Tax Court decision was discussed on pages 14059-14060 of Practical Drafting October 2020.

Another case of interest referred to in our prior discussions of the subject is *Estate of Brooks v. Comm'r of Revenue Servs.*, 325 Conn. 705, 159 A.3d 1149 (2017). This case involved the same fact situation where the surviving spouse died a domiciliary of Connecticut. The Connecticut Supreme Court held that the constitutionality of Connecticut's imposition of an estate tax on QTIP assets was valid and that a second transfer of QTIP assets occurred upon the death of the surviving spouse.

B. Oregon Supreme Court Decision in *Evans*

The opening paragraph of the *en banc* opinion by the Oregon Supreme Court *in Estate of Helene J. Evans v. Department of Revenue* provides:

This case reaches us on direct appeal from a decision of the Oregon Tax Court. The estate of Helene Evans, a deceased Oregon resident, challenges the Tax Court's determination that the Department of Revenue lawfully included in Evans's taxable Oregon estate the principal assets of a Montana trust, of which Evans had been the income beneficiary. Although Evans had a right to receive—and had received—income generated by those assets during her lifetime and potentially had the right to tap the assets themselves, the estate (plaintiff) asserts that she had not owned and had had no control over the assets. Under those circumstances, plaintiff argues, Oregon did not have the kind of connection to the trust assets that the Due Process Clause of the Fourteenth Amendment to the United States Constitution requires for a state to impose a tax on a person, property, or transaction. We conclude that Oregon's imposition of its estate tax on the trust assets in this case comports with the requirements of due process. We, therefore, affirm the judgment of the Tax Court.

At her death, Evans was an income beneficiary of a trust (the Gillam Trust) created by her husband, Donald, who died in 2012 a resident of Montana, a State without an estate tax. She moved to Oregon a few weeks after he died. His will created a trust for her and other beneficiaries and his son was named as sole trustee. The trust included intangible personal property. The terms of the will presented problems for marital deduction qualification and was modified (reformed) to support a QTIP election which was made and accepted by the IRS. As modified, the will provided that Evans could receive discretionary principal distributions the trustee deemed necessary for her "health, education, maintenance or support" in her "accustomed manner of living." During Evans' life, a change was made with respect to her interest in the trust by a settlement agreement pursuant to which she received a single payment of $750,000 from trust principal and fixed monthly payments of almost $11,000 per month.

On pages 13584-13591 of the July 2019 issue of Practical Drafting, a United States Supreme Court case similar to *Evans* was discussed and referred to by the Oregon Supreme Court opinion. *North Carolina Dept. of Rev. v. The Kimberley Rice Kaestner 1992 Family Trust*, 588 U.S. ____ (2019).

The Oregon Tax Court held that the Oregon estate tax did not violate the Due Process Clause. If:

(1) there is some minimum link or connection between the state and the person, property or transaction it seeks to tax; and (2) there is a rational relationship between the taxable item and the values and benefits that the taxing state provides.

The Oregon Supreme Court discussed at length the *Kaestner* case and noted:

Kaestner is only a starting point, however. Although it sets out a general rule requiring that an in-state trust beneficiary "have some degree of possession, control or enjoyment of the trust property or a right to receive that property" before the state can tax that property, it does not explore what might qualify as "some degree." The parties point to much earlier Supreme Court cases as sources of additional guidance regarding what it means for a resident of a state to have had "some degree of possession, control or enjoyment" of intangible trust assets such that, upon their death, those trust assets may be taxed as part of their estate. The parties focus their arguments on three estate tax cases, all decided within a two-year period some eighty years ago—*Curry*, 307 US 357, *Graves v. Elliot*, 307 US 383, 59 S Ct 913, 83 L Ed 1356 (1939), and *Whitney*, 309 US 530.

A discussion of the three cited cases included:

The parties here draw radically different conclusions from the foregoing cases about the correct application, in the estate tax context, of the *Kaestner* rule. To reiterate, *Kaestner* holds that, to the extent that a state relies on the in-state residency of a constituent of an out-of-state trust to tax the trust property, the demands of due process are satisfied only if the state-resident constituent has "some degree of possession, control or enjoyment of the trust property or a right to receive that property." ___ US at ___, 139 S Ct at 2222. Plaintiff contends that the cases all support its contention that a decedent who was the income beneficiary of an out-of-state trust must have had some *actual control* over the assets of the trust before the decedent's home state may impose its estate tax on those assets. More specifically, plaintiff adds, the cases show that "for due process purposes, the minimum, requisite control over the principal of a trust is the grant of at least some ability to decide or control how the trust principal will be invested, managed, or distributed." Plaintiff then asserts that, because Evans had had no ability to control how the Gillam Trust assets were invested, managed, or even distributed upon her death, Oregon could not rely on her in-state residency at the time of her death to establish the required minimum connection to those assets.

The department contends that *Curry*, *Graves*, and *Whitney* merely offer examples of how the due process requirement that the decedent have "some degree of possession, control or enjoyment of the trust property or a right to receive that property," *Kaestner*, ___ US at ___, 139 S Ct at 2222, may be satisfied and do not support the rule that plaintiff purports to draw from them. According to the department, those cases establish that a state may include the assets of an out-of-state trust in a decedent's estate when the decedent had either complete (in *Curry* and *Graves*) or more limited (*Whitney*) control respecting the disposition of the trust assets, but they do not establish that due process requires such control or requires any other specific feature in an in-state decedent's relationship with an out-of-state trust before the state of residence may impose its estate tax on the trust assets. In particular, the department contends that those cases do not speak to the circumstance here, in which decedent had a large degree of *enjoyment* of the trust property by virtue of her exclusive rights under the terms of the trust.

We agree with the department that the cited cases do not establish that a state may impose an estate tax on the assets of an out-of-state trust only if the deceased beneficiary had the ability to control how the assets of that out-of-state trust were managed, invested, or distributed. Instead, based on the rule announced in *Kaestner*, ___ US at ___, 139 S Ct at 2222, we conclude that the demands of due process also could be satisfied by a showing that a resident decedent had some degree of possession or enjoyment of, or right to receive, the trust property. See *Kaestner*, ___ US at ___, 139 S Ct at 2223-24 (demonstrating that court looks at whether beneficiaries had some enjoyment or future right to receive trust property, not just at whether they had right to control trust property, when considering "minimum connection" question).

Under a heading "APPLICATION," the opinion said:

Applying that standard to this case, we conclude that Evans had sufficient "enjoyment" of the trust principal (in addition to the enjoyment of the income generated thereby) to satisfy *Kaestner's* requirement of "some degree of possession, control, or enjoyment" of the trust assets and thus to permit Oregon to include those trust assets in Evans's taxable estate.

This statement was followed by a discussion of the particular facts of the case and the estate's contention that satisfying the *Kaestner* test is not sufficient to satisfy the Due Process Clause. The court's final paragraph concluded:

We have determined that Evans had sufficient enjoyment of the assets of the Gillam Trust during her lifetime that those assets cannot be dissociated from her, and that therefore, through Evans, Oregon had the minimum connection to the trust assets that due process requires before Oregon may tax the assets. And we have rejected plaintiff's additional arguments that, even if Oregon had the required minimum connection to the assets, its taxation of the assets is nonetheless unfair—and thus violates the Due Process Clause. It follows that the Tax Court did not err when it determined that Oregon's inclusion of the trust assets in Evans's Oregon estate was consistent with due process.

The likelihood of the United States Supreme Court granting *certiorari* in another similar case seems remote.

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