

Minnesota Department of Revenue

Revenue Notice # 23-01: Income Tax – Statutory Resident Trusts – Application of the Due Process Clause Minimum Connections Test

Introduction

This Revenue Notice states the Department’s position on how it will apply the due process minimum connections test to “resident trusts” under *Minnesota Statutes*, section 290.01, subdivision 7b (the “Minnesota Resident Trust Statute”) in light of the U.S. Supreme Court’s decision in *Kaestner* and the Minnesota Supreme Court’s decision in *Fielding*.¹

Background

The Minnesota Resident Trust Statute is subject to the requirements of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution and Minnesota’s version of that clause, *Minnesota Constitution*, article 1, section 7. The Minnesota Supreme Court “treat[s] the due process protections under the U.S. Constitution and the Minnesota Constitution identically.” *Fielding*, 916 N.W.2d at 327, n. 3.

The *Kaestner* decision describes the Due Process Clause as involving a two-step analysis:

First, [] there must be “some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.” Second, “the ‘income attributed to the State for tax purposes must be rationally related to ‘values connected with the taxing State.’””

To determine whether a State has the requisite “minimum connections” with the object of its tax, this Court borrows from the familiar test of *International Shoe Co. v. Washington*, 326 U.S. 310 (1945) [applicable to analyzing a state’s long-arm jurisdiction]. A State has the power to impose a tax only when the taxed entity has “certain minimum contacts” with the State such that the tax “does not offend ‘traditional notions of fair play and substantial justice.’” The “minimum contacts” inquiry is “flexible” and focuses on the reasonableness of the government’s action. Ultimately, only those who derive “benefits and protection” from associating with a State should have obligations to the State in question.

139 S.Ct. at 2219-20 (citations omitted). The Minnesota Supreme Court articulated the same two-step analysis in its decision in *Fielding*. 916 N.W.2d at 328-329.

¹ *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, 588 U.S. ___, 139 S.Ct. 2213 (2019); *Fielding v. Commissioner of Department of Revenue*, 916 N.W.2d 323 (Minn. 2018).

In *Fielding*, the Minnesota Supreme Court made clear that it “consider[s] factors [i.e., relevant connections] beyond those in the challenged residency statute” when deciding whether the minimum connections test is satisfied in a particular case. *Fielding*, 916 N.W.2d at 328. The Department applies this standard when reviewing resident trust tax matters.

Department Position

This Revenue Notice focuses on the first of these two steps – the minimum connections test.

A. Application of the Minimum Connections Test to Irrevocable *Inter Vivos* Trusts

Both the *Kaestner* decision and *Fielding* decision were limited to irrevocable *inter vivos* trusts.

In this section, the Department discusses the extent to which the *Kaestner* and *Fielding* decisions have identified relevant connections for due process purposes as applied to irrevocable *inter vivos* trusts.

1. Connections both decisions agree are relevant.

The U.S. Supreme Court and the Minnesota Supreme Court both agreed in their respective decisions that the following connections to a state are relevant for purposes of applying the minimum connections test:

- a. The State’s connection to the Trustee. *Kaestner*, 139 S.Ct. at 2220; *Fielding*, 916 N.W.2d at 330.
- b. The State’s connection to the Trust’s assets. *Kaestner*, 139 S.Ct. at 2221; *Fielding*, 916 N.W.2d at 331.
- c. The State’s connection to the administration of the Trust. *Kaestner*, 139 S.Ct. at 2220; *Fielding*, 916 N.W.2d at 331.

Accordingly, it is the Department’s position that the above-referenced connections are relevant for due process purposes.

2. Connections the *Kaestner* decision said are relevant and the *Fielding* decision said are irrelevant.

- a. The State’s connection to a resident beneficiary of the trust when there is evidence that the resident beneficiary has “some degree of possession, control or enjoyment of the trust property or a right to receive that property.” *Kaestner*, 139 S.Ct. at 2222. *But cf. Fielding*, 916 N.W.2d at 330.
- b. The State’s connection to a resident grantor of the trust when there is evidence that the resident grantor “retained ‘power to dispose of’ the [trust] property, which amounted to ‘a potential source of wealth which was property in her hands.’”

Kaestner, 139 S.Ct. at 2222, quoting from *Curry v. McCannless*, 307 U.S. 357, 370 (1939). *But cf. Fielding*, 916 N.W.2d at 331.

As noted above, the Minnesota Supreme Court “treat[s] the due process protections under the U.S. Constitution and the Minnesota Constitution identically.” As a result, it is the Department’s position that the above-referenced connections are relevant for due process purposes.

3. Connections the *Fielding* decision indicates are relevant, but which the *Kaestner* decision did not address.

- a. The Minnesota Supreme Court said in *Fielding* that a choice of law provision in a trust agreement selecting Minnesota law as the law governing the trust is not sufficient, “standing alone,” to tax *inter vivos* trusts as resident trusts. *Fielding*, 916 N.W.2d at 333. It is the Department’s position that the fact a choice of law provision appears in a trust agreement selecting Minnesota law as the law governing the trust is a relevant connection for due process purposes; however, it is not, standing alone, a sufficient connection.
- b. The *Fielding* decision indicates that it is a relevant connection for due process purposes if a person “represented [in Minnesota] the Trusts or the Trustees in connection with the activities that led to the income that the State seeks to tax.” *Id.* at 331 and n. 7 (discussing representation Minnesota law firm first provided to grantor and later provided to trusts). Accordingly, it is the Department’s position that it is a relevant connection when a person represents in Minnesota the trust or trustee in connection with the activities that led to the income Minnesota seeks to tax.²
- c. The *Fielding* decision indicates that where a testamentary trust is “subject to the continuing supervisory jurisdiction” of a Minnesota court, including for “litigation” and “claims,” that continuing supervisory jurisdiction may be a relevant connection for due process purposes. *Fielding*, 916 N.W.2d at 333 and n. 9. Consequently, it is the Department’s position that the fact that a Minnesota court has continuing supervisory jurisdiction over an *inter vivos* trust is a relevant connection for due process purposes.

4. To be relevant, a connection must occur in the tax year at issue.

² The *Fielding* Court stated that “the grantor’s decision to use a Minnesota law firm to draft the trust documents” is not a relevant connection for due process purposes. *Fielding*, 916 N.W.2d at 331. The Court further stated that the fact that the same law firm represents the trust in the tax proceedings before the Court “is not relevant to the activities that generated the income that the State seeks to tax.” *Id.* at 331, n. 7.

In *Fielding*, the Minnesota Supreme Court is clear that only those connections that exist in the tax year at issue are relevant for purposes of due process analysis. *Fielding*, 916 N.W. 2d at 332. Similarly, the U.S. Supreme Court in *Kaestner* focused on the connections that took place during “the relevant tax year.” While the U.S. Supreme Court never stated that the only connections relevant for due process purposes are those that occurred during the tax years at issue, the Supreme Court referenced the importance of this fact in discussing connections that would pass constitutional muster. *See, e.g., Kaestner*, 139 S.Ct. at 2223. Based on the foregoing, it is the Department’s position that, to be relevant for purposes of application of the minimum connections test to an irrevocable *inter vivos* trust, the connection must exist in the tax year at issue.

B. Application of the Minimum Connections Test to Irrevocable Testamentary Trusts

The *Fielding* and *Kaestner* decisions both contain narrow holdings, limited to irrevocable *inter vivos* trusts. *Fielding*, 916 N.W.2d at 334; and *Kaestner*, 139 S.Ct. at 2221. Consequently, neither the *Fielding* decision nor the *Kaestner* decision offers precedential authority with respect to relevant connections to be considered with respect to irrevocable testamentary trusts. However, it is the Department’s position that these decisions do offer persuasive authority that their holdings ought to apply to all trusts – irrevocable *inter vivos* trusts and irrevocable testamentary trusts alike.

It is the Department’s position that all of the connections the Department determined are relevant with respect to irrevocable *inter vivos* trusts in Section A above are also relevant with respect to irrevocable testamentary trusts. The Department refers to these connections collectively as “Trust/Applicable Year Connections”.

The Department has further determined that each of the following connections is also relevant with respect to irrevocable testamentary trusts, notwithstanding that they may not have occurred in the tax year at issue:

1. The testamentary trust was created by a will of a decedent who at death was domiciled in the state.
2. The testamentary trust and the will under which it was created were probated in the state.

See District of Columbia v. Chase Manhattan Bank, 689 A.2d 539 (D.C. 1997), discussed by the Minnesota Supreme Court in *Fielding*. 916 N.W.2d at 331 and n. 6.

The Department refers to these two connections collectively as “Grantor/Court Connections”.

The Department’s position is that the Trust/Applicable Year Connections and the Grantor/Court Connections may, in the appropriate case, be applied separately or in combination, to satisfy the due process minimum connections test with respect to irrevocable testamentary trusts.

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A handwritten signature in cursive script that reads "Terese Mitchell". The signature is written in black ink and is positioned above a horizontal line.

Terese Mitchell

Director

Appeals, Legal Services, and Disclosure Division