STATE OF MINNESOTA — TAX COURT

COUNTY OF RAMSEY — REGULAR DIVISION

William Fielding, Trustee of the Reid and Ann MacDonald Irrevocable GST Trust for Maria V. MacDonald, et al.,

Appellants,

vs.

Commissioner of Revenue,

Appellee.

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

File Nos. 8911-R, 8912-R 8913-R, 8914-R

Filed: May 31, 2017

These matters came before The Honorable Bradford S. Delapena, Judge of the Minnesota Tax Court, on the parties' cross-motions for summary judgment.

Walter A. Pickhardt and Caitlin E. Abram, Faegre Baker Daniels LLP, represent appellants William Fielding, Trustee of the Reid and Ann MacDonald Irrevocable GST Trust for Maria V. MacDonald, et al.

Kyle W. Wislocky, Assistant Minnesota Attorney General, represents appellee Commissioner of Revenue.

Each appellant Trust appeals an order of the Minnesota Commissioner of Revenue denying an income tax refund claim.[1] As relevant here, Minnesota law defines "resident trust" in part as "an irrevocable trust, the grantor of which was domiciled in this state at the time it became

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[1] Stip. ¶ 19. The four appellant trusts are the Reid and Ann MacDonald Irrevocable GST Trust for Maria V. MacDonald ("Maria Trust"); the Reid and Ann MacDonald Irrevocable GST Trust for Catherine Gray MacDonald ("Catherine Trust"); the Reid and Ann MacDonald Irrevocable GST Trust for Laura Reid MacDonald ("Laura Trust"); and the Reid and Ann MacDonald Irrevocable GST Trust for Vandever R. MacDonald ("Vandever Trust") (collectively, the "Trusts").

irrevocable." Minn. Stat. § 290.01, subd. 7b(a)(2) (2016). Under this provision, once an *inter vivos* trust becomes irrevocable, it is forever treated as a "resident trust" based on the single circumstance that its grantor "was domiciled in this state at the time the trust became irrevocable." No other connection with Minnesota is then, or ever, required or even relevant.

Residency generally authorizes a state to tax a taxpayer's worldwide income regardless of source. Accordingly, if a trust qualifies as a Minnesota *resident* trust, "[i]ncome or gains from intangible personal property *not employed in the business of the recipient*" are "assigned to"—and thus taxed by—Minnesota. Minn. Stat. § 290.17, subd. 2(c) (2016) (emphasis added). In contrast, such income and gains earned by a nonresident trust are *not* assigned to Minnesota. Minn. Stat. § 290.17, subd. 2(e) (2016). Thus, by defining a trust as a "resident trust," Minnesota asserts authority to tax trust income and gains from all sources—including income and gains from intangible assets having no relation to Minnesota.

Each Trust filed a 2014 Minnesota income tax return treating itself as a "resident trust" and paid tax (under protest) on income and gains from intangible personal property the Trust asserted had no relation to Minnesota.[2] Each Trust then filed an amended return treating itself as a nonresident trust, computing its tax liability by excluding income and gains from intangible personal property not related to Minnesota, and requesting a refund. Applying section 290.01,

[2] A trust is a fiduciary relationship, Restatement (Third) of Trusts § 2 (2003), that is taxed as an entity, *Anderson v. Wilson*, 289 U.S. 20, 27 (1933). It is well settled that the domicile of the trustee—the person with possession and legal title of trust of assets—may tax a trust. *See Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486, 497 (1947) (commenting that nothing in the Court's jurisprudence "leads to the conclusion that a state may not tax intangibles in the hands of a resident trustee of an out-of-state trust"); *Safe Deposit & Trust Co. of Balt. v. Virginia*, 280 U.S. 83, 91 (1929) ("Manifestly, the securities are subject to taxation in Maryland where they are in the actual possession of the trust company - holder of the legal title."). Sufficient connections may permit other states to tax a trust as well. Because the Trusts' trustees were domiciled outside of Minnesota during 2014, the question here is whether—consistent with due process—Minnesota may tax the Trusts as "residents," on their worldwide income.

subdivision 7b(a)(2), which defines each Trust as a "resident trust," the Commissioner denied the Trusts' refund claims. The Trusts timely appealed to this court.

The Trusts do not dispute that they qualify as "resident trusts" under section 290.01, subdivision 7b(a)(2). Instead, they contend that—as applied to them—the statute violates the due process provisions of the Minnesota and United States constitutions and the Commerce Clause of the Federal Constitution. The parties have filed cross-motions for summary judgment on the Trusts' constitutional claims. We grant the Trusts' motions for summary judgment and deny the Commissioner's motions.

The court, upon all the files, records, and proceedings herein, now makes the following:

ORDER

1. The Trusts' motions for summary judgment are granted.

2. The Commissioner's motions for summary judgment are denied.

IT IS SO ORDERED. THIS IS A FINAL ORDER. LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT,

Bradford S. Delapena, Judge
MINNESOTA TAX COURT

DATED: May 31, 2017

MEMORANDUM

I. FACTUAL AND PROCEDURAL BACKGROUND

The issue in these consolidated cases is whether Minnesota may lawfully tax capital gains that appellant Trusts realized during 2014 from the sale of certain stock, along with other income from intangible personal property located outside of Minnesota. In conjunction with their cross-motions for summary judgment, the parties filed an extensive stipulation of facts concerning the creation and funding of the Trusts; the trustees and beneficiaries; the Trusts' income and gains during 2014; and the history of the parties' tax dispute.

A. Creation And Initial Funding

William Fielding is the current trustee of the four appellant Trusts. Each was created by an irrevocable agreement ("Trust Agreements") dated June 25, 2009, between Reid V. MacDonald ("Grantor") and Edmund B. MacDonald, Jr., as trustee.[3] Laura Carlson, a Minneapolis attorney, represented Grantor in drafting the Trust Agreements.[4] Grantor was domiciled in Minnesota during 2009, when the Trusts were created, and at all times since 2009.[5] The Trusts' current mailing address is that of Mr. Fielding, in Johnson City, Texas.[6]

Approximately two weeks after creating the Trusts, by means of a stock-transfer certificate dated July 9, 2009, Grantor funded each trust with 6,021 shares of nonvoting common stock in Faribault Foods, Inc. ("FFI"), a Minnesota Subchapter S corporation.[7] FFI recorded the stock

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[3] Stip. ¶ 2. The Trust Agreements are Exhibits J9 to J12.

[4] Stip. ¶ 4.

[5] Stip. ¶ 3.

[6] Stip. ¶ 1.

[7] Stip. ¶ 5.

transfer as effective August 1, 2009.[8] Edmund MacDonald, in his capacity as trustee, thus acquired possession and legal title of trust assets, which passed to his successor trustees.[9]

B. Change In Status For Tax Purposes

From June 25, 2009, through December 31, 2011, the Trusts were "grantor type trusts" for Minnesota income tax purposes, because Grantor retained a power to exchange personal assets for Trust assets of equivalent value.[10] For this period, trust income was treated as income to Grantor, and was taxable as such. On December 31, 2011, however, Grantor signed for each Trust a release of his power to exchange assets.[11] The Trusts thus became "resident trusts" under Minnesota law,[12] and were thereafter treated as entities themselves subject to state income tax.

C. Trustees And Trust Administration

The Trusts had only one trustee at any time, who was the same for each Trust.[13] At no time was any trustee domiciled in Minnesota.[14] Edmund MacDonald, a California domiciliary, was the initial trustee, serving from August 1, 2009, through December 31, 2011.[15]

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[8] Stip. ¶ 5.

[9] *See, e.g.*, Ex. J09 at FIE000001, FIE000023.

[10] Stip. ¶ 6. *See* Minn. Stat. § 290.01, subd. 7b(a) (2016) ("The term 'grantor type trust' means a trust where the income or gains of the trust are taxable to the grantor or others treated as substantial owners under sections 671 to 678 of the Internal Revenue Code.").

[11] Stip. ¶ 7.

[12] Stip. ¶ 8. *See* Minn. Stat. § 290.01, subd. 7b(a)(2) (defining "[r]esident trust" as "an irrevocable trust, the grantor of which was domiciled in this state at the time the trust became irrevocable," and further providing that "a trust is considered irrevocable to the extent the grantor is not treated as the owner thereof under sections 671 to 678 of the Internal Revenue Code").

[13] Stip. ¶ 14.

[14] Stip. ¶ 14.

[15] Stip. ¶ 15; Ex. J13 (MacDonald resignation).

Katherine A. Boone was trustee between January 1, 2012, and July 24, 2014.[16] She was a Colorado domiciliary for the entire period, and never traveled to Minnesota.[17] During 2014, Boone made all discretionary decisions concerning distributions to beneficiaries and investment of trust assets while in Colorado.[18]

Ms. Boone resigned and appointed Mr. Fielding trustee, effective July 24, 2014.[19] He continues to serve as trustee of the Trusts, and has been a Texas domiciliary throughout his service.[20] Fielding has never travelled to Minnesota on trust-related business.[21] During 2014, Fielding made all discretionary decisions concerning distributions to beneficiaries and investment of trust assets while in Texas.[22]

During 2014, Ms. Boone and Mr. Fielding maintained records of trust assets and income.[23] Boone "kept bank account statements and income tax returns in Colorado";[24] Fielding "kept bank account statements, investment information and account statements, income tax returns and information about the proposed sale of FFI in Texas."[25] Although attorney Carlson initially maintained the original Trust Agreements in Minnesota, she mailed them to Fielding on September 19, 2014.[26] In their capacity as trustees of the Trusts, the trustees "have not been

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[16] Stip. ¶¶ 16, 18; Exs. J14 to J15 (Boone appointment and acceptance).

[17] Stip. ¶ 18.

[18] Stip. ¶¶ 102-03.

[19] Stip. ¶¶ 17, 19; Ex. J16 (Boone resignations; Fielding appointments and acceptances).

[20] Stip. ¶ 19.

[21] Stip. ¶ 20.

[22] Stip. ¶¶ 102-03.

[23] Stip. ¶ 105.

[24] Stip. ¶ 105.

[25] Stip. ¶ 105.

[26] Stip. ¶ 107.

plaintiffs or defendants in any legal action filed in the courts of Minnesota or of any other state, except for the instant cases pending in the Minnesota Tax Court." [27]

D. Beneficiaries

The primary beneficiary of the Maria Trust is Grantor's daughter, Maria V. MacDonald. Maria was born in Minnesota in 1985. She was domiciled in California during 2014, and remains a California domiciliary. Maria filed a California resident income tax return for 2014. She did not maintain a place of abode in Minnesota at any time during 2014.[28]

The primary beneficiary of the Catherine Trust is Grantor's daughter, Catherine Gray MacDonald. Catherine was born in Minnesota in 1986. She was domiciled in New York during 2014. Catherine moved to California in 2015, and remains a California domiciliary. Catherine filed a New York resident income tax return for 2014. She did not maintain a place of abode in Minnesota at any time during 2014.[29]

The primary beneficiary of the Laura Trust is Grantor's daughter, Laura Reid MacDonald. Laura was born in Minnesota in 1988. She was domiciled in New York during 2014. Laura moved to California in 2015, and remains a California domiciliary. Laura filed a New York resident income tax return for 2014. She did not maintain a place of abode in Minnesota at any time during 2014.[30]

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[27] Stip. ¶ 104.

[28] Stip. ¶ 21.

[29] Stip. ¶ 22.

[30] Stip. ¶ 23.

The primary beneficiary of the Vandever Trust is Grantor's son, Vandever R. MacDonald. Vandever was born in Minnesota in 1993. He was domiciled in Minnesota during 2014, but attended college in New York. Vandever filed a Minnesota resident income tax return for 2014.[31]

E. Additional Trust Assets

During 2011, each Trust acquired 16,223 additional shares of nonvoting common stock in FFI.[32] Consequently, between December 31, 2011, and August 1, 2014, when the stock was sold, each Trust owned 22,244 shares in FFI.[33] The only other asset in each Trust, prior to sale of the FFI stock, was cash held in a Wells Fargo checking account.[34]

F. Sale Of The FFI Stock

Each Trust Agreement recited that Grantor assigned, transferred, and delivered to the trustee certain properties, and provided that "[t]he legal title to the trust property shall be and remain vested in the Trustee and any successor …."[35] The trustee of each Trust has the power "[t]o sell … any or all of the properties of the Trust Estate at such prices, on such terms, to such persons, in such portions, and in such manner as the Trustee may in each case deem proper and advisable."[36] In July 2014, Mr. Fielding reviewed information about a proposed sale of FFI stock to La Costeña USA, Inc. He also participated in a conference call of shareholders on July 24, 2014, to discuss the possible transaction.[37] Fielding exercised his discretion to sell the FFI stock

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[31] Stip. ¶ 24.

[32] Stip. ¶ 25.

[33] Stip. ¶ 25.

[34] Stip. ¶ 26; Exs. J17A to J20B (Trusts' checking account statements).

[35] *See, e.g.*, Ex. J09 at FIE000001, FIE000023.

[36] Stip. ¶ 63 (quoting section 5.1(4) of each Trust Agreement).

[37] Stip. ¶ 62.

held by each Trust to La Costeña on August 1, 2014.[38] All other FFI shareholders likewise sold their stock that same day.[39]

There were 526,310.80 shares of FFI stock outstanding at the time of sale, of which 47,846.40 were shares of voting common stock and 478,464.40 were shares of nonvoting common stock. All outstanding shares received the same price. Each Trust owned 22,244 shares of nonvoting common stock in FFI, and was thus entitled to receive 4.226 percent of the sale proceeds (22,244/526,310.80).[40]

G. Disposition Of Sale Proceeds

Each Trust's Wells Fargo checking account statement reflects a substantial deposit in August 2014—proceeds received at the closing of the FFI stock sale. The bank statements likewise reflect that each Trust received two lesser deferred payments, one in September 2014 and one in December 2014.[41]

In October 2014, Mr. Fielding entered into an Asset Management Agreement for each Trust with Wells Fargo.[42] Fielding gave Wells Fargo full discretion to manage (purchase, sell, or retain) trust assets in accordance with the Investment Policy Statement for each account.[43] On October 20, 2014, Fielding approved the transfer of funds from each Trust's checking account to its new investment account.[44] Wells Fargo managed the Trusts' investment accounts from its offices in

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[38] Stip. ¶ 63.

[39] Stip. ¶ 64.

[40] Stip. ¶ 65.

[41] Stip. ¶ 31.

[42] Stip. ¶ 32; Exs. J21 to J24 (Asset Management Agreements).

[43] Stip. ¶ 32.

[44] Stip. ¶ 37.

San Francisco, California.[45] The Wells Fargo checking and investment account statements are the only records of trust assets and income during 2014 (other than tax returns).[46]

H. Distributions To Beneficiaries During 2014

Under the Trust Agreements, the trustee "may distribute to or for the benefit of the Primary Beneficiary such sum or sums from either the net income from or the principal of such separate trust, including the whole thereof, as the Trustee, in the exercise of the Trustee's discretion, may deem necessary or advisable from time to time."[47] Exercising this discretion, the trustees (first Ms. Boone, and then Mr. Fielding) made both periodic and one-time distributions during 2014. Maria, Catherine, and Laura each received a monthly distribution for eleven months of 2014;[48] Vandever received one for all twelve months.[49] Maira also received a one-time distribution during October (to assist in the purchase of a residence).[50]

I. Income Tax Reporting

Each Trust timely filed a 2014 Minnesota income tax return as a Minnesota "resident trust" under Minn. Stat. § 290.01, subd. 7b(a)(2), paid the reported tax under protest, and included a statement asserting that the statutory definition was unconstitutional.[51] Each Trust next filed an amended 2014 Minnesota return prepared *without* treating itself as a Minnesota "resident trust."[52] The amended returns excluded from each Trust's taxable income: (1) gain from the 2014 FFI

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[45] Stip. ¶ 38.

[46] Stip. ¶ 43; Exs. J25 to J28 (Trusts' 2014 investment account statements).

[47] Stip. ¶ 44 (quoting section 4.2(2) of each Trust Agreement).

[48] Stip. ¶ 45, 48, 52.

[49] Stip. ¶ 52.

[50] Stip. ¶¶ 45-46.

[51] Stip. ¶ 88; Exs. J49 to J52 (Trusts' 2014 Minnesota income tax returns).

[52] Stip. ¶ 93; Exs. J53 to 56 (Trusts' amended 2014 Minnesota income tax returns).

stock sale; and (2) income from the Trust's Wells Fargo investment account (administered in California). Briefly, the Trusts argued that the stock and investment accounts are intangible personal property located outside of Minnesota, and that Minnesota may not lawfully tax income or gains attributable to those assets. On this basis, each of three Trusts requested a substantial refund.[53]

In addition to filing a Minnesota income tax return, each Trust also filed state income tax returns in Arizona, California, Colorado, and Illinois.[54]

II. General Principles

The Trusts ask us to rule as a matter of law that Minnesota's definition of "resident trust," as applied to them, violates the due process provisions of the Minnesota and United States constitutions and the Commerce Clause of the Federal Constitution. The Commissioner asks us to rule as a matter of law that the challenged statute is constitutional as applied to the Trusts.

Summary judgment shall be rendered if the pleadings, the record in the case, and any supporting affidavits show that there is no genuine issue as to any material fact and that a party is entitled to judgment as a matter of law. Minn. R. Civ. P. 56.03; *DLH, Inc. v. Russ*, 566 N.W.2d 60, 69 (Minn. 1997). When, as here, parties file cross-motions for summary judgment, they tacitly agree that there are no genuine issues of material fact. *Am. Family Mut. Ins. Co. v. Thiem*, 503 N.W.2d 789, 790 (Minn. 1993). Summary judgment is a suitable vehicle for addressing the application of law to undisputed facts. *See A. J. Chromy Constr. Co. v. Commercial Mech. Serv., Inc.*, 260 N.W.2d 579, 581 (Minn. 1977).

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[53] Stip. ¶¶ 94-97.

[54] Stip. ¶¶ 98-101; Exs. J57 to J73 (Trusts' original and amended state income tax returns filed in states other than Minnesota).

Minnesota statutes are presumed constitutional. *Kimberly-Clark Corp. & Subsidiaries v. Comm'r of Revenue*, 880 N.W.2d 844, 848 (Minn. 2016). The Minnesota Supreme Court has emphasized: "We exercise our power to declare a statute unconstitutional with extreme caution and only when absolutely necessary." *Luther v. Comm'r of Revenue*, 588 N.W.2d 502, 508 (Minn. 1999). "Accordingly, [a court] will uphold a statute unless the challenging party demonstrates that it is unconstitutional beyond a reasonable doubt." *Caterpillar, Inc. v. Comm'r of Revenue*, 568 N.W.2d 695, 697-98 (Minn. 1997).[55]

III. CHALLENGED STATUTE

Minnesota Statutes section 290.01, subdivision 7b, defines "resident trust" for state income tax purposes, and provides, in part:

> (a) Resident trust means a trust, except a grantor type trust, which either (1) was created by a will of a decedent who at death was domiciled in this state or (2) is an irrevocable trust, the grantor of which was domiciled in this state at the time the trust became irrevocable.

Minn. Stat. § 290.01, subd. 7b(a). Expressly excluded from this definition is a "grantor type trust," as to which "the income or gains of the trust *are taxable to the grantor* [rather than to the trust itself] … under sections 671 to 678 of the Internal Revenue Code." *Id.* (emphasis added). Correspondingly, a trust is a "resident trust" "to the extent the grantor *is not treated as the owner thereof* under sections 671 to 678 …." *Id.* (emphasis added). To precisely this latter extent, the

[55] The Legislature created the tax court as an administrative agency of the executive branch. *See* Minn. Stat. § 271.01, subd. 1 (2016). Generally, our jurisdiction is limited to "questions of law and fact arising under the tax laws of the state." Minn. Stat. § 271.01, subd. 5 (2016). When, however, a case first comes to us by transfer from the district court, or when a case is transferred to, and back again from, the district court (a procedure known as the "Erie Shuffle"), we acquire jurisdiction to decide constitutional matters. *See Wilson v. Comm'r of Revenue*, 619 N.W.2d 194, 199-200 (Minn. 2000). Because an Erie Shuffle was completed in each case, we have jurisdiction to decide the Trusts' constitutional challenges.

trust itself—rather than the grantor—is liable for tax on trust income or gains. These cases involve irrevocable *inter vivos* trusts (rather than testamentary trusts "created by a will of a decedent").

The foregoing definition of "resident trust" does *not* apply to all irrevocable *inter vivos* trusts. Instead, it applies only "to trusts ... that became irrevocable after December 31, 1995, or are first administered in Minnesota after December 31, 1995." Minn. Stat. § 290.01, subd. 7b(a). A second definition of "resident trust" governs trusts "that are not governed under paragraph (a)." Minn. Stat. § 290.01, subd. 7b(b). This second definition provides:

> A trust, except a grantor type trust, is a resident trust only if two or more of the following conditions are satisfied:
>
> (1) a majority of the discretionary decisions of the trustees relative to the investment of trust assets are made in Minnesota;
>
> (2) a majority of the discretionary decisions of the trustees relative to the distributions of trust income and principal are made in Minnesota;
>
> (3) the official books and records of the trust, consisting of the original minutes of trustee meetings and the original trust instruments, are located in Minnesota.

Minn. Stat. § 290.01, subd. 7b(b). A separate subdivision addresses how to apply these nexus criteria when a trustee delegates decision-making authority. *See* Minn. Stat. § 290.01, subd. 7b(c).

IV. DUE PROCESS CONSTRAINTS ON STATE TAXATION OF INCOME

The Minnesota and United States constitutions both provide that no person shall be deprived "of life, liberty, or property without due process of law." Minn. Const. art. I, § 7; U.S. Const. amend. XIV, § 1. With respect to state taxation, due process imposes two constraints. First, there must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). Second, "the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.' " *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978) (citation omitted).

A. Two-Component Nexus Inquiry

Due process nexus actually "embodies two discrete inquiries: first, is there a minimum connection with (and hence, jurisdiction over) the taxpayer; second, is there a minimum connection with (and hence, jurisdiction over) the activity the state seeks to tax." Walter Hellerstein, *State Taxation* ¶ 6.02 (3d ed. 2017) [hereinafter Hellerstein] (footnote omitted). The first inquiry involves "whether a state has a sufficient connection or 'nexus' with the taxpayer ... to permit the state to compel the taxpayer ... to comply with the state's tax obligations." *Id.*, ¶ 6.01[1]. "These are essentially questions of personal or *in personam* jurisdiction." *Id.*; *see also Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992) ("The constitutional question in a case such as *Quill Corp.* is whether the State has the authority to tax the corporation at all."). The second (but discrete) inquiry "may involve questions of whether a state has power over the subject matter of the tax." Hellerstein ¶ 6.01[2]. As the Supreme Court has explained, "in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." *Allied-Signal*, 504 U.S. at 778. "Failure to distinguish clearly between these two aspects of taxing jurisdiction can confuse the proper understanding and analysis of jurisdiction-to-tax questions." Hellerstein ¶ 6.01.[56]

[56] *See also* Hellerstein ¶ 6.04 (reiterating that personal and subject matter jurisdiction are "two discrete inquiries" and cautioning that "it is important to address them separately because failing to distinguish between the precise jurisdictional questions under consideration can lead to confusion and unsound analysis").

1. Personal Jurisdiction

A state's jurisdiction to tax a person is evaluated under familiar due process principles. *Quill Corp. v. North Dakota*, 504 U.S. 298, 307-08, 312 (1992). Applying these principles, the Supreme Court rejected Quill's claim that North Dakota lacked jurisdiction to require Quill to collect and remit North Dakota use tax. *Id.* at 303. Quill sold office equipment and supplies to North Dakota customers, soliciting business through catalogs and flyers, advertisements in national periodicals, and telephone calls. *Id.* Quill had no employees in North Dakota, owned no tangible property there, and delivered all merchandise to customers by common carrier. *Id.* Although Quill had no physical presence in North Dakota, the Supreme Court sustained North Dakota's personal jurisdiction over Quill:

> [T]here is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

Id. at 308.

2. Subject Matter Jurisdiction

If a state has personal jurisdiction, the next question is whether it also has subject matter jurisdiction. In this case, we deal with the taxation of income. "There are two fundamental, but alternative, bases for state power to tax income: residence and source." Hellerstein ¶ 6.04.

a. Residency

The Supreme Court has long held that residency confers jurisdiction to tax *all* of a taxpayer's income *without regard to source*. *See, e.g.*, *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937). In *Graves*, a New York resident challenged that state's jurisdiction to tax "income [she] received from rents of land located without the state [in New Jersey] and from interest on bonds physically without the state and secured by mortgages upon lands similarly situated." *Id.* at 310-12. The Court rejected this challenge:

> That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. ... A tax measured by the net income of residents ... is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state.

Id. at 312-13. The Court emphasized that this conclusion was not "affected by the character of the source from which the income is derived," commenting that "[a] state may tax its residents upon net income from a business whose physical assets, located wholly without the state, are beyond its taxing power." *Id.* at 313; *see also Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462-63 (1995) (applying the "well-established principle of interstate and international taxation—namely, that a jurisdiction ... may tax *all* of the income of its residents, even income earned outside the taxing jurisdiction"). Residency, then, confers subject matter jurisdiction over a person's worldwide income *without regard to source.*[57]

b. Source

For nonresident taxpayers, in contrast, subject matter jurisdiction must be established for each source of income. *See, e.g., Shaffer v. Carter*, 252 U.S. 37, 57 (1920). In *Shaffer*, the Court contrasted a state's taxing power over residents and nonresidents, respectively:

> As to residents [the state] may, and does, exert its taxing power over their income from all sources, whether within or without the state .... As to nonresidents, the jurisdiction extends only to their property owned within the state and their business,

[57] Minnesota taxes all of a resident individual's income. *See* Minn. Stat. § 290.014, subd. 1 (2016) ("All net income of a resident individual is subject to tax under this chapter."); Minn. Stat. § 290.17, subd. 1(a) (2016) ("The income of resident individuals is not subject to allocation outside this state."); *Luther*, 588 N.W.2d at 507 ("If a taxpayer is a Minnesota 'resident,' Minnesota taxes her worldwide net income.").

> trade, or profession carried on therein, and the tax is only on such income as is derived from those sources.

Id.; *see also Chickasaw Nation*, 515 U.S. at 463 n.11 (noting that for nonresident taxpayers "jurisdictions generally may tax only income earned within the jurisdiction"); *Luther*, 588 N.W.2d at 507 ("The state taxes the income of nonresidents only to the extent that income is derived from activities within Minnesota."). Thus, even when a state has personal jurisdiction over a nonresident taxpayer, the state may tax only income derived from in-state sources—*not* the taxpayer's worldwide income. "The bedrock constitutional principle that a state may not tax activities with which it lacks a concrete connection generally confines the exercise of a state's tax power to activities conducted within its borders." Hellerstein ¶ 8.07.

The more constrained taxing power arising from the source justification is well illustrated by two aspects of business taxation: apportionment and tax-base limitation. Under the source justification, when a nonresident taxpayer's business is carried on partly within and partly without a state, the state may tax income derived only from the business' local activities. This can be achieved by "separate geographic accounting." *See Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 438 (1980).[58] The Supreme Court has long held, however, that "a State need not attempt to isolate the intrastate income-producing activities from the rest of the business; it may tax an apportioned sum of the corporation's multistate business if the business is unitary." *Allied-Signal*, 504 U.S. at 772. The Court has thus approved apportionment as an adequate method for establishing the amount of income derived from a multistate business's in-state activities. *Moorman*, 437 U.S. at 273 & n.6 (commenting that apportionment "is employed as a rough

[58] "Separate accounting is a method for determining the geographic source of a taxpayer's income through segregation of the profits attributable to a state through identification of state specific receipts, costs, and expenses from the taxpayer's books and records." Hellerstein ¶ 8.03.

approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State").

The source justification likewise prohibits a state from including in the apportionable tax base income from property or activities unrelated to a nonresident taxpayer's in-state business. In *Allied-Signal*, a nondomiciliary corporation sought an income tax refund because New Jersey had included in its apportionable tax base the gain Allied-Signal had realized on its sale of stock in a separate corporation (ASARCO, Inc.), one unrelated to Allied-Signal's business conducted partly within New Jersey. *Allied-Signal*, 504 U.S. at 773-76.

The Court ruled that New Jersey lacked jurisdiction to tax Allied-Signal's gain on the ASARCO stock sale. *Id.* at 790. Based on the stipulated facts, the Court easily concluded that the two entities—Bendix and ASARCO—were *not* engaged in a unitary business. *Id.* at 774-75, 788. It also concluded that Allied-Signal's investment in ASARCO stock had no operational role in Allied-Signal's business operations. *Id.* at 788-89.

The Court agreed with certain New Jersey *amici curiae* "that the Constitution does not require a unitary business relation between the payor and the payee in order for a State to apportion the income the payee corporation receives from an investment in the payor." *Id.* at 786. "What is required instead is that the capital transaction serve an operational rather than an investment function." *Id.* at 787.

> Hence, for example, a State may include within the apportionable income of a nondomiciliary corporation the interest earned on short-term deposits in a bank located in another State if that income forms part of the working capital of the corporation's unitary business, notwithstanding the absence of a unitary relationship between the corporation and the bank.

Id. at 787-88.

In sum, although the Supreme Court's contemporary due process jurisprudence "rejects a rigid, formalistic definition of minimum connection," the Court has not "abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." *Id.* at 778. Subject matter jurisdiction—the need to establish that income was derived from in-state activity—thus remains a significant limitation upon a state's power to tax nonresident taxpayers.[59]

B. Relation Between Income Taxed And Benefits Conferred

The second requirement of due process is that the "income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.' " *Moorman*, 437 U.S. at 273 (citation omitted). This requirement is violated when a state taxes "extraterritorial values wholly unrelated" to a taxpayer's in-state business. *F. W. Woolworth Co. v. Taxation & Revenue Dep't of State of N. M.*, 458 U.S. 354, 372 (1982) (citation omitted); *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 134, 135 (1931) (reversing an assessment where the state apportionment formula "operate[d] so as to reach profits which [were] in no just sense attributable to transactions within its jurisdiction," and thus attributed to the taxpayer "income out of all appropriate proportion to the business transacted ... in that state"). The requirement is satisfied, on the other hand, when "the tax is fairly apportioned to the commerce carried on within the State." *Ott v. Miss. Valley Barge Line Co.*, 336 U.S. 169, 174 (1949); *see also Container Corp.*

[59] Under Minnesota law, capital transactions that serve solely an investment function fall under the definition of "nonbusiness income," and must be assigned to the taxpayer's domicile:

> Nonbusiness income is income of the trade or business that cannot be apportioned by this state because of the United States Constitution or the Constitution of the state of Minnesota and includes income that cannot constitutionally be apportioned to this state because it is derived from a capital transaction that solely serves an investment function. Nonbusiness income must be allocated ....

Minn. Stat. § 290.17, subd. 6 (2016).

v. Franchise Tax Bd., 463 U.S. 159, 169 (1983) (holding that the Due Process Clause requires an apportionment formula to be "fair").

V. THE TRUSTS' DUE PROCESS CLAIM

The Trusts claim that section 290.01, subdivision 7b(a)(2), violates due process as applied to them because under that provision, "the Trusts will be classified as resident trusts, and be subject to Minnesota income tax on income and gains from intangibles, for as long as the Trusts exist (probably decades) based *solely* on the historic fact that Reid MacDonald was domiciled in Minnesota on December 31, 2011." [60] According to the Trusts, this single "historical fact" is not an adequate basis to designate a taxpayer a "resident trust," and thus to tax its worldwide income:

> Minnesota cannot subject the Trusts to income tax on 100 percent of their investment income by classifying them as "resident trusts," a classification that depends entirely on the domicile of the grantor on December 31, 2011, the date the Trusts were deemed to be irrevocable. The vestigial connection of the grantor is not a permissible basis for classifying a trust as a resident.[61]

Specifically, the Trusts allege that Minnesota had no authority to tax them on: (1) gains from the 2014 sale of FFI stock (intangible assets possessed by trustees domiciled outside of Minnesota); or (2) income from the Trusts' Wells Fargo investment accounts (administered in California), because these amounts were "[i]ncome or gains from intangible personal property not employed in the business of the recipient." Minn. Stat. § 290.17, subd. 2(c). They ask us to rule as a matter of law that section 290.01, subdivision 7b(a)(2) is unconstitutional as applied to them, and to reverse the Commissioner's orders denying their refund claims.[62]

[60] Appellants' Mem. Supp. Summ. J. 2-3 (filed Jan. 27, 2017) (footnote omitted).

[61] Appellants' Mem. Supp. Summ. J. 32.

[62] Appellants' Mem. Supp. Summ. J. 43.

Alleging that "[t]he Trusts seek to curtail Minnesota's power to define trust residency," [63] the Commissioner argues that the Trusts "cannot meet their burden to prove a constitutional violation beyond a reasonable doubt." [64] In a section titled "The Trusts Have Many Links To Minnesota," the Commissioner argues that the State "has extended a host of benefits to the Trusts in this case." [65] Specifically, the Commissioner points to the following:

- "All four Trusts were created by Grantor MacDonald, a Minnesota domiciliary";
- "All four original trust documents were drafted by [a] Minnesota attorney … , and they state they are to be interpreted according to the laws of the State of Minnesota";
- "From the time of the Trusts' creation until late 2014, the trust documents were kept in Minnesota";
- "Vandever Macdonald [sic], one of the four primary beneficiaries, was domiciled in Minnesota in 2014"; and
- "[T]he Trusts' primary trust asset and source of income during 2014 was stock in FFI, a closely held S-Corporation which was incorporated in the State of Minnesota and has always been headquartered in Minnesota." [66]

Citing these and other factors, the Commissioner argues that foreign cases analyzing due process challenges to the taxation of trusts "confirm that Minnesota is well within constitutional bounds in taxing the Trusts in this case." [67] The Commissioner thus asks us to reject the Trusts' due process challenge and to affirm her orders.[68]

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[63] Appellee's Mem. Supp. Summ. J. 11 (filed Jan. 27, 2017).

[64] Appellee's Mem. Supp. Summ. J. 1.

[65] Appellee's Mem. Supp. Summ. J. 8.

[66] Appellee's Mem. Supp. Summ. J. 8. *See also id.* at 22 ("The State's justification for taxing the Trusts as residents … is that the State has provided a wide array of benefits to the Trusts as the state of their creation, the state of incorporation of FFI, and the state of domicile for Grantor MacDonald and beneficiary Vandever.").

[67] Appellee's Mem. Supp. Summ. J. 15-20.

[68] Appellee's Mem. Supp. Summ. J. 1, 25.

The Trusts rejoin that the Commissioner misstates the issue by framing it as whether Minnesota has power to tax the Trusts (in some way): "The issue is whether Minnesota can tax the Trusts *as resident trusts*." [69] They explain: "Here, the Commissioner does not want to tax an apportioned share of the gain from selling FFI stock; she wants to tax 100 percent of that gain.... [S]he also wants to tax 100 percent of non-FFI intangible income (including dividends from mutual funds). In other words, she wants to tax the Trusts as residents of Minnesota." [70] Then, responding to the Commissioner's list of benefits allegedly conferred on them, the Trusts argue: "The Court should not supplement the statutory language by adding factors to the one factor specified in the statute for classifying an inter vivos trust as a resident trust: the historical domicile of the grantor." [71]

VI. Analysis

Before proceeding, we must resolve two preliminary questions arising from the parties' arguments, as just summarized: the issue presented, and the factors upon which we may rely in evaluating due process connection.

A. Issue Presented

We think the issue presented is: Whether, for due process purposes, the domicile of the grantor alone is a sufficient connection with Minnesota to justify taxing the Trusts *as residents* (that is, on a tax base that includes intangible personal property *not* related to Minnesota). We agree with the Trusts, in other words, that the issue is not simply whether the State has personal jurisdiction to tax the Trusts. This conclusion is supported by several considerations.

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[69] Appellants' Reply Mem. 1 (filed Feb. 17, 2017) (emphasis added).

[70] Appellants' Reply Mem. 2.

[71] Appellants' Reply Mem. 2 (sentence capitalization modified).

First, the parties have stipulated "that the Trusts are Minnesota 'resident trusts' as that term is defined in Minn. Stat. § 290.01, subd. (7b)(a)(2)." [72] Second, it is undisputed that Minnesota taxed the Trusts *as residents*. Pursuant to section 290.17, subdivision 2(c), Minnesota *assigned to itself* "income or gains from intangible personal property not employed in the business of" the Trusts.[73] Referring to the Trusts, the Commissioner's opening submission states: "They were taxed on this gain [from the FFI stock sale] as resident trusts." [74] Finally, the Trusts do *not* dispute that Minnesota properly taxed them—as shareholders of a Subchapter S corporation generating income in Minnesota—on operating income arising from FFI's in-state business activities.[75] Instead, their challenge pertains to the State's taxation of gains from the sale of FFI stock held by the trustee outside of Minnesota.[76] The question is thus whether Minnesota may tax the Trusts *as residents*, on gains from the sale of intangible assets not related to Minnesota.[77]

B. Scope Of The Court's Due Process Connection Inquiry

We must next determine the proper scope of our due process connection inquiry. The Trusts argue that we should not "supplement the statutory language [of section 290.01,

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[72] Stip. ¶ 8.

[73] Appellee's Mem. Supp. Summ. J. 9.

[74] Appellee's Mem. Supp. Summ. J. 1.

[75] Appellants' Mem. Supp. Summ. J. 2 n.2, 17 & n.19.

[76] Gain on the sale of S corporation stock is allocable to Minnesota to the extent provided by Minn. Stat. § 290.17. *See* Minn. Stat. § 290.014, subd. 3(1) (2016). Section 290.17 provides, in part, that "[i]ncome or gains from intangible personal property not employed in the business of the recipient of the income or gains *must be assigned to this state if the recipient of the income or gains is ... a resident trust*." Minn. Stat. § 290.17, subd. 2(c) (2016) (emphasis added). For a nonresident trust, in contrast, gains from intangible personal property not employed in the taxpayer's trade or business "shall be assigned to the taxpayer's domicile." *Id.*, subd. 2(e).

[77] Under the Trust Agreements, the trustee has possession and legal title of trust assets. *See, e.g.*, Ex. J9 at FIE000001, FIE000023. Ms. Boone, who was trustee from January 1 through July 24, 2014, was a Colorado domiciliary. Stip. ¶ 18. Mr. Fielding, who was trustee from July 24 through December 31, 2014, was a Texas domiciliary. Stip. ¶ 19.

subdivision 7b(a)(2)] by adding factors to the one factor specified in the statute for classifying an inter vivos trust as a resident trust: the historical domicile of the grantor."[78] The Trusts thus argue that we should determine whether the grantor's domicile at the time the Trusts became irrevocable *alone* can justify taxing the Trusts as residents. The Commissioner, on the other hand, contends that we should consider "all the contacts between Minnesota and the Trusts" when analyzing the Trusts' as-applied due process challenge.[79]

We agree with the Commissioner that as-applied challenges are analyzed under all the relevant circumstances. *See, e.g.*, *Rew v. Bergstrom*, 845 N.W.2d 764, 780 (Minn. 2014). The Commissioner simply *assumes*, however, that all the contacts between Minnesota and the Trusts are relevant when applying section 290.01, subdivision 7b(a)(2). We cannot agree.

When evaluating a constitutional challenge to a statute, a court must first determine the statute's meaning; must next apply the statute in accordance with legislative intent; and only then must decide whether the statute, as applied, violates the constitution. *State v. Muccio*, 890 N.W.2d 914, 919-20 (Minn. 2017) (so proceeding); *Wuertz v. Garvey*, 287 Minn. 353, 354-55, 178 N.W.2d 630, 631-32 (1970) (same). Statutory interpretation and application thus precede constitutional adjudication. *Muccio*, 890 N.W.2d at 920. When considering the Trusts' as-applied challenge to section 290.01, subdivision 7b(a)(2), therefore, we must identify the specific circumstances upon which the Legislature intended to base residency for purposes of that provision.

C. Interpretation Of Section 290.01, Subdivision 7b

"The object of all interpretation and construction of laws is to ascertain and effectuate the intention of the legislature." Minn. Stat. § 645.16. (2016). Legislative intent is determined

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[78] Appellants' Reply Mem. 2 (sentence capitalization modified).

[79] Appellee's Reply Mem. 2 (filed Feb. 17, 2017) (citing *Rew v. Bergstrom*, 845 N.W.2d 764, 780 (Minn. 2014)).

"primarily from the language of the statute itself." *Brayton v. Pawlenty*, 781 N.W.2d 357, 363 (Minn. 2010) (quoting *Gleason v. Geary*, 214 Minn. 499, 516, 8 N.W.2d 808, 816 (1943)). When initially ascertaining the meaning of a particular provision, a court considers related provisions: "It is a cardinal rule of statutory construction that a particular provision of a statute cannot be read out of context but must be taken together with other related provisions *to determine its meaning*." *Kollodge v. F. & L. Appliances, Inc.*, 248 Minn. 357, 360, 80 N.W.2d 62, 64 (1956) (emphasis added). Courts thus "interpret each section in light of the surrounding sections to avoid conflicting interpretations," *Am. Family Ins. Grp. v. Schroedl*, 616 N.W.2d 273, 277 (Minn. 2000), and to "harmonize and give effect to all its parts," *Van Asperen v. Darling Olds, Inc.*, 254 Minn. 62, 73-74, 93 N.W.2d 690, 698 (1958). "When the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit." Minn. Stat. § 645.16.

The challenged statute contains two separate definitions of "resident trust." The subdivision 7b(a)(2) definition specifies a single criterion for determining the residency of an *inter vivos* trust: the domicile of the grantor when the trust became irrevocable. Minn. Stat. § 290.01, subd. 7b(a)(2). Under the plain meaning of this definition, residency is determined by a single, historical fact.

The subdivision 7b(b) definition, in contrast, enumerates several criteria for determining residency, all focusing on whether a trust is administered in Minnesota. Minn. Stat. § 290.01, subd. 7b(b). More specifically, residency under this definition turns on whether certain discretionary investment and distribution decisions "are made" in Minnesota, and whether certain trust-related documents "are located" in Minnesota. Minn. Stat. § 290.01, subd. 7b(b)(1)-(3).[80] For economy, we refer to the subdivision 7b(a) definition as the "grantor-domicile rule," and the subdivision 7b(b) definition as the "Minnesota-nexus rule."

Each rule contains language specifying its intended scope of application. By its express terms, subdivision 7b(a) applies to *inter vivos* trusts "that became irrevocable after December 31, 1995, or are first administered in Minnesota after December 31, 1995." Minn. Stat. § 290.01, subd. 7b(a). Subdivision 7b(b) applies to trusts "that are not governed under paragraph (a)." Minn. Stat. § 290.01, subd. 7b(b). These complementary scope provisions thus divide all covered trusts into two separate buckets. The grantor-domicile rule applies exclusively to trusts in the first bucket, while the Minnesota-nexus rule applies exclusively to trusts in the second.

Based on the plain meaning of section 290.01, subdivision 7b—particularly when subdivisions 7b(a) and 7b(b) are read together and harmonized—it is clear that the Legislature intended Minnesota's two definitions of "resident trust" to be mutually exclusive, and to apply to two discrete categories of trusts. Accordingly, we conclude that the sole factor upon which the Legislature intended to base residency for purposes of the grantor-domicile rule is the domicile of the grantor at the time a trust became irrevocable.

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[80] Income tax is imposed on an annual basis. *See* Minn. Stat. § 290.03(3) (2016) (imposing "[a]n annual tax for each taxable year ... upon the taxable income for such year" of "[t]rusts ... however created by residents or non-residents"). Residency is thus determined on an annual basis. *See, e.g.*, *Stelzner v. Comm'r of Revenue*, 621 N.W.2d 736, 739 (Minn. 2001) (upholding the Commissioner's determination "that the Stelzners were nondomiciliary residents of Minnesota for each year of the audit period"). Accordingly, the Legislature's use of the present tense in framing the nexus criteria contained in section 290.01, subdivision 7b(b) indicates its intention to refer to facts in existence during each separate tax year. *Cf. Marks v. Comm'r of Revenue*, 875 N.W.2d 321, 325 (Minn. 2016) (discussing how to apply the State's nondomiciliary resident statute to the facts obtaining during the particular tax year in issue).

"When the Legislature's intent is discernible from plain and unambiguous language, statutory construction is neither necessary nor permitted; and courts apply the statute's plain meaning." *State v. Jones*, 848 N.W.2d 528, 535 (Minn. 2014) (citing *Am. Tower, L.P. v. City of Grant*, 636 N.W.2d 309, 312 (Minn. 2001)). Recourse to general nexus factors when applying the grantor-domicile rule would affirmatively contravene the Legislature's clear intention to create two separate rules, based on separate notions (grantor domicile and nexus), applying two separate sets of criteria. Consequently, when analyzing the Trusts' as-applied challenge to the grantor-domicile rule, we will ask whether the domicile of the grantor—standing alone—is a sufficient connection upon which to justify taxing the Trusts as Minnesota residents. *See supra* § VI.A (issue presented). We will not, as the Commissioner requests, consider other (nexus) factors such as the storage in Minnesota of trust instruments or the Minnesota domicile of a beneficiary.[81]

D. Grantor-Domicile As A Basis For Resident Tax Treatment

As previously indicated, due process permits state taxation of two different scopes, based on two discrete justifications, associated with two separate levels of state connection. Hellerstein ¶ 6.04:

Justification	**Connection**	**Scope of Income Taxation**
Residency	Domicile	Worldwide income
Source	Minimum connection	Income from in-state sources only

Here, the State taxed the Trusts *as residents*, on their worldwide income. The Trusts argue that the domicile of the grantor, standing alone, is an insufficient basis to justify that scope of taxation. We thus agree with the Commissioner that the determinative question is whether due process

[81] Appellee's Mem. Supp. Summ. J. 8, 13, 16-18, 25.

"curtail[s] Minnesota's power to define trust residency." [82] Specifically, it is whether *the domicile of the grantor at the time the trust became irrevocable* is a connection of sufficient substance to replace *the domicile of the taxpayer itself* as a justification for taxing worldwide income. Reviewing the pertinent authorities, we conclude it is not.[83]

1. *Mercantile-Safe Deposit*

The first is *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 19 A.D.2d 765, 242 N.Y.S.2d 26 (1963), *aff'd*, 203 N.E.2d 490 (N.Y. App. Div. 1964). In 1953, the grantor, a New York domiciliary, "transferred and delivered to" the trustee, a Maryland domiciliary, "3500 shares of the capital stock of a certain corporation." *Id.* at 765, 242 N.Y.S.2d at 27. The grantor subsequently "bequeathed cash and securities to an amount exceeding $1,000,000 to the trustee for the uses and purposes of the trust." *Id.* at 765, 242 N.Y.S.2d at 27. The trust indenture provided that upon the grantor's death, his wife would become the trust's income beneficiary, "subject to the power of the trustee in its absolute discretion to withhold and accumulate all or any part of the trust income otherwise payable to her and to merge it with the principal of the fund from which it was derived." *Id.* at 765, 242 N.Y.S.2d at 27. Although the grantor's wife (a New York resident) survived him, the trustee "exercised the granted power to accumulate the trust income, [] filed no

[82] Appellee's Mem. Supp. Summ. J. 11.

[83] If due process did not limit the manner in which states define residency—and thus the manner in which they assert authority to tax worldwide income—states could easily circumvent due process limitations upon the source-justification. Under the source-justification, a nonresident who earns income in a state may be taxed on that income (and only that income). Surely, a state could not—simply by expanding its definition of "resident" to include anyone who earned income in the state—suddenly tax that person's worldwide income. *Cf. D.C. v. Chase Manhattan Bank*, 689 A.2d 539, 544 (D.C. 1997) ("The fact that the District calls some entity—be it a trust, individual, or corporation—a 'resident' does not, by itself, give the District any greater power over that entity than it would have in the absence of such a statutory classification."); *Blue v. Dep't of Treasury*, 411, 462 N.W.2d 762, 764-65 (Mich. Ct. App. 1990) (noting that the court was "unpersuaded by [the State's] arguments that the fact that the trust is defined as a resident trust imparts legal protections and jurisdiction" to tax the trust).

[New York] State income tax returns reporting its receipt for the succeeding taxable periods and [] paid no income tax thereon." *Id.* at 765, 242 N.Y.S.2d at 27-28. The State conceded that "the trustee is domiciled in the State of Maryland, that the trust is administered there and that the intangibles constituting its corpus have been at all times in its exclusive possession and control in that State." *Id.* at 765, 242 N.Y.S.2d at 28.

New York's intermediate appellate court sustained the trustee's due process challenge to New York's statutory scheme purporting to authorize taxation of the trust's accrued (undistributed) income. The court acknowledged that the trust "must be deemed a resident trust by statutory definition." *Id.* at 765, 242 N.Y.S.2d at 28 (citation omitted). It reasoned, however, that "the related statutes which impose a tax upon [the trust's] accrued income undertake ... to extend the taxing power of the State to property wholly beyond its jurisdiction and thus conflict with the due process clause of the Fourteenth Amendment." *Id.* at 765-66, 242 N.Y.S.2d at 28 (citations omitted). The court found no merit in the state's "continuing jurisdiction theory." *Id.* at 766, 242 N.Y.S.2d at 28. New York's highest court affirmed, commenting that "[t]he 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." *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490, 491 (N.Y. 1964).

2. *Potter*

The domicile of the grantor was expressly rejected as a sufficient basis for resident tax treatment in *Potter v. Taxation Division Director*, 5 N.J. Tax 399 (1983). In 1972, the settlor, a New Jersey domiciliary, created an irrevocable *inter vivos* trust "by transferring $25 in cash to ... the sole trustee of her trust." *Id.* at 402. The settlor subsequently transferred further assets to the trustee both during her lifetime and through her will, which was probated in New Jersey in 1976. *Id.* Aside from these historical connections, the trust had no connections with New Jersey:

> All income of the trust is derived from sources outside New Jersey. Since the establishment of the trust, the trust assets, consisting of cash, securities, an interest in a Delaware limited partnership and real property in Massachusetts (disposed of in 1976), have been located and managed outside New Jersey. The beneficiaries and the trustee have resided outside New Jersey at all times since the inception of the trust.

Id. at 402-03. After the trustee filed a 1980 New Jersey income tax return showing no tax due, the State of New Jersey assessed the trust on its undistributed income. *Id.* at 401, 403.

The trustee contended "that imposition of the gross income tax on the undistributed income of this trust violates the Due Process Clause," because there were "insufficient contacts with New Jersey to subject the income of this trust to taxation." *Id.* at 403. New Jersey responded that there was sufficient nexus because "the settlor was a New Jersey domiciliary at the time of the creation of the trust and at the time of her death," and because she transferred assets to the trust "during [her] lifetime and after her death in accordance with her will." *Id.*

The court concluded that "New Jersey does not have the authority to tax this *inter vivos* trust for the tax year in question and, therefore, [the challenged taxing statute] may not constitutionally be applied in the subject case." *Id.* at 405. The court reasoned:

> The ability of the State of New Jersey to tax the undistributed income of this *inter vivos* trust depends on the existence of sufficient contacts and benefits to comply with constitutional due process requirements. The domicile of the settlor at the time of the creation of the irrevocable *inter vivos* trust is not in itself a sufficient contact to support taxation by New Jersey.

Id. at 404. The court rejected New Jersey's theory that protections the state had furnished during previous calendar years could establish taxing jurisdiction for 1980, the tax year in issue:

> Receipt of the principal assets of the trust from the New Jersey domiciliary prior to her death in 1976, and the December 1977 receipt of a substantial portion of the "pour-over" assets from the estate of the New Jersey domiciliary are acts which occurred prior to the tax year in question.

Id. at 404-05.[84]

3. *Blue*

In *Blue v. Department of Treasury*, 462 N.W.2d 762 (Mich. Ct. App. 1990), the court found no taxing jurisdiction despite a state statute that defined the trust as a "resident trust" based on the domicile of the grantor. In 1961, the grantor, a Michigan resident, created a revocable living trust that became irrevocable a year later, upon the grantor's death. *Id.* at 763. Between 1982 and 1987, the tax years in issue, the trust's sole income beneficiary was a Florida resident, the sole trustee lived in Florida, "[a]ll of the trust's assets and other indicia of ownership [were] located in Florida ... [and] all brokerage accounts and bank accounts [were] held and administered in Florida." *Id.* The trustee sought to recover taxes paid to Michigan on accumulated trust income for the tax years in issue. *Id.*

Michigan law defined a "resident trust" as "one created by a person domiciled in Michigan at the time the trust became irrevocable." *Id.* (statutory citation omitted). The trustee alleged that resident tax treatment based on this definition violated due process "by attempting to tax activities and assets beyond the boundaries and control of the state." *Id.* Michigan responded "that the continuing residency of the trust within Michigan and the benefits and protections of laws of this state extended to the trust established the requisite nexus and jurisdiction to impose a tax." *Id.* at 764. The court concluded that the challenged statute, by "defining the present trust as a resident trust subject to Michigan income tax, violates the due process clause." *Id.* at 765.

The court first noted that "[a]n income tax is justified only when contemporary benefits and protections are provided the subject property or entity during the relevant taxing period." *Id.*

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[84] The court further noted that assets entering the trust through probate were subject to the state's inheritance tax, and that distributions exiting the trust to in-state beneficiaries were taxable to the beneficiaries themselves. *Potter*, 5 N.J. Tax at 405.

at 764 (quoting *In re Swift*, 727 S.W.2d 880, 882 (Mo. 1987)). It ultimately concluded that "there are insufficient connections between the trust and the State of Michigan to justify the imposition of an income tax ... where neither the trustee nor the trust property are within the state." *Id.* The court found "no ongoing protection or benefit to the trust," especially considering that "[a]ll of the income-producing trust property [was] located in Florida," the sole income beneficiary and the sole trustee were domiciled in Florida, and "[m]ost importantly, the trust [was] administered and registered in Florida." *Id.*

The court emphatically rejected the notion that the state had the power to tax the trust simply because a statute defined it as a "resident trust":

> We are unpersuaded by [Michigan's] arguments that the fact that the trust is defined as a resident trust imparts legal protections and jurisdiction. We find that these protections are illusory considering that the trust is registered and administered in Florida. The state cannot create hypothetical legal protections through a classification scheme whose validity is constitutionally suspect and attempt to support the constitutionality of the statute by these hypothetical legal protections.

Id.

4. *Linn*

The court in *Linn v. Department of Revenue*, 2 N.E.3d 1203 (Ill. Ct. App. 2013), likewise ruled that due process prohibited Illinois from taxing a trust's income simply by virtue of a statute that defined the trust as a "resident" based on the grantor's domicile at the time the trust became irrevocable. The Autonomy Trust 3 was created in 2002 from the assets of a pre-existing irrevocable trust established in 1961 by an Illinois resident, *id.* at 1204-05, 1210, who the parties agreed was therefore the grantor of Autonomy Trust 3, *id.* at 1208. In 2006, the tax year in issue, none of the trust beneficiaries were Illinois residents, the trustee "resided in Texas, and the [trust] was administered in Texas. The [trust] had no assets in Illinois." *Id.* at 1206. The trust reported no 2006 income from Illinois sources and thus paid no Illinois tax. *Id.* Illinois, however, "reclassified the [trust] as an Illinois resident under [the definitional statute], taxed 100% of the trust's reported income, and assessed a deficiency liability." *Id.*

Illinois law defined "resident" to include "[a]n irrevocable trust, the grantor of which was domiciled in [Illinois] at the time such trust became irrevocable." *Id.* at 1207-08 (statutory citation omitted). The trustee argued that "[w]ithout any connections to Illinois [in 2006], the imposition of Illinois income tax on the [trust] would be unconstitutional under the due process clause." *Id.* at 1208.

After reviewing the same authorities we have just summarized, the court noted that Illinois had cited "no cases finding a grantor's in-state residency is a sufficient connection for due process with an *inter vivos* trust" and, indeed, that "decisions from other states have found the grantor's in-state residence insufficient to establish a minimum connection." *Id.* at 1210. It next observed that "with income taxation, the focus of the due process analysis is on the tax year in question." *Id.* (citation omitted).

The court found that "no connections appear to exist with the trust in this case." *Id.* at 1208. Moreover, the court specifically concluded that "the fact the Autonomy Trust 3's grantor was an Illinois resident is not a sufficient connection to satisfy due process." *Id.* at 1210. The court thus concluded that "insufficient contacts exist between Illinois and the [trust] to satisfy the due process clause, and thus the income tax imposed on the [trust] for the tax year 2006 was unconstitutional." *Id.* at 1211.

5. *Gavin*

The Commissioner finds support for taxation of the Trusts as "residents" in *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999). Although *Gavin* upheld the resident tax treatment of an *inter vivos* trust, that result was supported principally by a factor *other than the grantor's domicile*. *Id.* at 801-02 ("In the present case, the critical link to the undistributed income sought to be taxed is the fact that the non-contingent beneficiary of the inter vivos trust during the tax year in question was a Connecticut domiciliary."). We have already concluded that consideration of such separate nexus factors when applying section 290.01, subdivision 7b(a)(2), would contravene the will of the Legislature.[85] *See supra* § VI.B. In addition, the court's reasoning in *Gavin* actually supports the Trusts' position that—as a discrete historical connection—the domicile of the grantor alone is not sufficient to justify the resident tax treatment of an *inter vivos* trust:

> [The trustee] also argues that implicit in the due process test for taxation are the requirements "that the benefits provided by the State seeking to tax be contemporaneous with the imposition of the tax," and that there be a nexus between the benefits provided by the state and "the earning of the income which is the subject of the taxation." To the extent that the first of these implicit requirements, namely, contemporaneity, suggests that the benefits be more than historical, we agree. We think that it is implicit in the due process test that the benefits afforded by the state to a domiciliary, or its functional equivalent, justifying the taxation of its income, must generally span the time period during which the income was earned, and not solely antedate that time period without any continuing effect.

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[85] Even if we could consider the domicile of a beneficiary when evaluating state connection under the grantor-domicile rule, we would place no reliance on that factor. For *Gavin* was incorrectly decided insofar as it relies on the domicile of trust *beneficiaries* as a basis for jurisdiction to tax a trust. *See Safe Deposit & Trust Co. of Balt.*, 280 U.S. at 89-93 (concluding that due process prohibited Virginia from taxing the trustee, a Maryland resident, upon the corpus of a trust (intangible assets held by the trustee) even though the trust's beneficiaries were Virginia domiciliaries); *Brooke v. City of Norfolk*, 277 U.S. 27, 28-29 (1928) (concluding that due process prohibited Virginia from taxing the beneficiary on the entire corpus of a trust (as distinguished from distributions to her) where "the property is not within the State, does not belong to the [beneficiary] and is not within her possession or control"). *See also Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Dep't of Revenue*, 789 S.E.2d 645, 649-51 (N.C. Ct. App. 2016) (reviewing authorities and similarly concluding that the residence of a beneficiary does not confer jurisdiction to tax a trust), *writ allowed*, 793 S.E.2d 683 (N.C. 2016).

Gavin, 733 A.2d at 801.[86]

6. Application of Authorities And Conclusion

Each of the foregoing cases involves a state's attempt to tax worldwide income by *defining* an *inter vivos* trust as a "resident." The attempt failed in all but one case (*Gavin*), which is distinguishable. In the other cases, courts determined that the applicable residency definition did not require state connection of sufficient substance to justify resident tax treatment under the Due Process Clause of the Fourteenth Amendment.

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[86] *Gavin* also upheld the state's taxation of four *testamentary* trusts. *Gavin*, 733 A.2d at 785, 790-801. The Commissioner likewise relies on two other testamentary trust cases. *See* Appellee's Mem. Supp. Summ. J. 15-18 (citing *Westfall v. Dir. of Revenue*, 812 S.W.2d 513 (Mo. 1991), and *In re Swift*, 727 S.W.2d 880 (Mo. 1987)). The Trusts contend that testamentary trusts are distinguishable, and that "[t]he case for asserting jurisdiction to tax a testamentary trust based on the domicile of the decedent ... is probably a stronger one because of the connection that a testamentary trust has to the state's probate courts." Appellants' Mem. Supp. Summ. J. 26 n.25. Courts have so reasoned, emphasizing the *ongoing* provision of state protections *to the testamentary trust itself*. In *Gavin*, for example, the court considered "whether the contacts between the testamentary trusts and Connecticut are sufficient constitutionally for Connecticut to treat the trusts as if they were domiciliaries." *Gavin*, 733 A.2d at 793. The court held in the affirmative, noting that Connecticut law provided for the creation of the testamentary trusts and determined their validity. *Id.* at 795. In addition, the State's courts assured "the continued existence of the trusts as mechanisms for the disposition of the testators' property according to the terms of the trusts as provided by the respective wills." *Id.* Another court has noted that "[a] testamentary trust, like a corporation, is a creature of the laws of the state where it is created and owes its very existence to those laws." *D.C. v. Chase Manhattan Bank*, 689 A.2d 539, 544 (D.C. 1997). The court concluded "that the Due Process Clause does not prevent the District from imposing [an annual net income tax on the testamentary trust], given the continuing supervisory relationship which the District's courts have with respect to administration of such a trust." *Id.* at 540. In precisely these respects, however, the court distinguished *inter vivos* trusts:

> [T]he nexus between the [inter vivos] trust and the District is arguably more attenuated, since the trust was not created by probate of the decedent's will in the District's courts. An irrevocable inter vivos trust does not owe its existence to the laws and courts of the District in the same way that the testamentary trust at issue in the present case does, and thus it does not have the same permanent tie to the District. In some cases the District courts may not even have principal supervisory authority over such an inter vivos trust.

Id. at 547 n.11. Here, of course, we deal with *inter vivos* rather than testamentary trusts.

In *Potter*, *Blue*, *Linn*, and *Gavin*—as in the present case—the "resident trust" definition was based on the domicile of the grantor at the time the *inter vivos* trust became irrevocable. All four courts rejected this historical connection *with the grantor* as sufficient to establish taxing jurisdiction over a trust. To satisfy due process, the courts reasoned, state protections must be contemporaneous with the accumulation of the income to be taxed. Because protections extended to the grantor when the *inter vivos* trust became irrevocable were—by hypothesis—extended *at that discrete historical moment*, they could not support taxing jurisdiction for subsequent tax years. Hoping to highlight the inadequacy of a purely historical connection with the grantor to justify perpetual taxing jurisdiction over a trust, one court commented:

> We analogize the present case to a hypothetical statute authorizing that any person born in Michigan to resident parents is deemed a resident and taxable as such, no matter where they reside or earn their income. We believe this would be clearly outside of the state's power to impose taxes.

Blue, 462 N.W.2d at 764-65.

It is unsurprising that courts have universally rejected state efforts to tax trusts as "residents" based solely on the domicile of the grantor at the time an *inter vivos* trust became irrevocable. As the *Blue* Court's analogy indicates, this manner of asserting jurisdiction over a trust suffers from at least two separate problems.

First, it reaches *back through time* to a discrete historical moment, and purports to rely on state protections extended (to the grantor) at that moment. But as the foregoing cases indicate, due process does not permit this resort to protections provided exclusively in previous tax years: the protections provided "must generally span the time period during which the income was earned, and not solely antedate that time period without any continuing effect." *Gavin*, 733 A.2d at 801. In addition, because the domicile of the grantor at the moment an *inter vivos* trust became irrevocable is a matter of historical fact, it is—as to the trust—an immutable characteristic.

Consequently, residency under this factor will be *perpetual*, and the due process problem associated with reaching back through time will worsen with each passing year.

Second, the grantor-domicile method of asserting taxing jurisdiction over a trust reaches *across persons*. Rather than relying on connections *with the trust itself*, it relies instead on connections with the trust's grantor. There is no doubt that domicile establishes a substantial connection between the taxing state and the grantor. But a connection with the grantor at the time the trust became irrevocable does not entail any connection with the trust at that same moment. *Potter* perfectly illustrates the point.

In that case, the New Jersey settlor transferred assets "consisting of cash, securities, an interest in a Delaware limited partnership and real property in Massachusetts" to a trustee residing outside of New Jersey. *Potter*, 5 N.J. Tax at 402-03. In rejecting New Jersey's attempt to tax the trust based on the grantor's domicile, the court noted: "Since the establishment of the trust, the trust assets ... have been located and managed outside New Jersey. The beneficiaries and the trustee have resided outside New Jersey at all times since the inception of the trust." *Id.* at 402-03. Thus, even at the time the grantor created the irrevocable *inter vivos* trust in 1972, the State of New Jersey furnished the trust no real protections.

The infirmity of the grantor-domicile rule is further demonstrated by the relative superficiality of the connection upon which it relies. Even if the grantor's domicile were a cognizable connection *between an inter vivos trust and the taxing state*, that connection would not approach in substance the connections courts have ruled sufficient to justify resident tax treatment. Plainly, it does not compare in substance with domicile—with a trust's *own* domicile in a state.

Under Minnesota law, domicile for a natural person "means the bodily presence of an individual person in a place coupled with an intent to make such a place one's home." Minn. R.

8001.0300, subp. 2 (2015). The substantive quality of domicile is illustrated by the Commissioner's enumeration of 26 factors that "will be considered in determining whether or not a person is domiciled in this state." *Id.*, subp. 3; *Dreyling v. Comm'r of Revenue*, 753 N.W.2d 698, 703-04 (Minn. 2008) (listing the numerous connections to Minnesota establishing the taxpayer as a Minnesota domiciliary). Domicile is equally substantive for an entity. Corporate domicile, for example, is "[t]he place considered by law as the center of corporate affairs, where the corporation's functions are discharged; the legal home of a corporation, usu. its state of incorporation or the state in which it maintains its principal place of business." *Corporate domicile*, *Black's Law Dictionary* 593 (10th ed. 2014).

The domicile of the grantor likewise does not compare in substance with the connections required by Minnesota's nondomiciliary resident statute: 183 days physically present in Minnesota along with the maintenance of an abode here. Minn. Stat. §290.01, subd. 7(b) (2016). The Minnesota Supreme Court recently explained that the State's nondomiciliary resident statute "in particular serves the purpose of requiring individuals who avail themselves of Minnesota's services, benefits, and protections *through substantial contact with the state* for most of the year *to pay taxes on their entire income.*" *Marks*, 875 N.W.2d at 327 (emphasis added). Although this justification for "resident" tax treatment is not based on domicile, it nevertheless relies on "substantial contact with the state" sufficient to warrant taxing the taxpayer's "entire income." *Id.* Domicile of the grantor involves no such present and substantial connections.

In accordance with the foregoing authorities, we conclude that the domicile of the grantor at the time a trust became irrevocable—standing alone—is not a sufficient basis to justify the resident tax treatment of an *inter vivos* trust. We have previously ruled that the sole state connection we may consider when evaluating residency under section 290.01, subdivision 7b(a)(2), is the domicile of the grantor at the time the *inter vivos* trust became irrevocable. *See supra* § VI.C. Consequently, we conclude that section 290.01, subdivision 7b(a)(2), as applied to the Trusts for tax year 2014, violates the due process provisions of the Minnesota and United States constitutions.[87]

Because Minnesota did not have a sufficient basis to tax the Trusts as "residents," and thus to allocate to itself "[i]ncome or gains from intangible personal property *not employed in the business of the recipient*," Minn. Stat. § 290.17, subd. 2(c) (emphasis added), it was without authority to tax each Trust on: (1) gain from the 2014 FFI stock sale; and (2) 2014 income from the its Wells Fargo investment account (administered in California).[88] Put another way, Minnesota did not have subject matter jurisdiction over gain and income from these items of intangible personal property not located within Minnesota.[89] Consequently, the Commissioner erred in denying the Trusts' refund claims. We grant the Trusts' motions for summary judgment and deny the Commissioner's motions.

B.S.D.

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[87] Because we resolve this case on due process grounds, we do not reach the Trusts' Commerce Clause claims.

[88] We reject the Commissioner's contention that *International Harvester Co. v. Wis. Department of Taxation*, 322 U.S. 435 (1944) and *Wis. v. J.C. Penney Co.*, 311 U.S. 435 (1940) support Minnesota's attempt to tax the Trusts' worldwide income without regard to source. *See* Appellee's Mem. Supp. Summ. J. 11-15. Indeed, those cases merely affirm a state's power to tax income *from in-state sources*. *Int'l Harvester*, 322 U.S. at 442 ("We think that Wisconsin may constitutionally tax the Wisconsin earnings distributed as dividends to the stockholders."); *J.C. Penney*, 311 U.S. at 442, 446 (noting that where the "practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin," the "incidence of the tax as well as its measure is tied to the earnings which the State of Wisconsin has made possible").

[89] Our ruling is *not* based on lack of personal jurisdiction over the Trusts, a matter about which we express no opinion.