



Trustees Should Evaluate Income Tax Impact of *Fielding v. Commissioner*

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Trustees of irrevocable trusts have a new income tax issue to evaluate. On July 18, 2018, the Minnesota Supreme Court concluded the application of a Minnesota income tax law to specific irrevocable trusts was unconstitutional in *Fielding v. Commissioner*. The ruling presents an opportunity for other trustees to consider whether they should amend prior tax returns or perhaps change their income tax returns going forward.

Background of the Case: Minnesota's current law requires a "resident trust" to pay Minnesota income tax on all of the trust's income. A "resident trust" means a trust, except a grantor trust, that became irrevocable or was first administered in Minnesota after 1995 if the trust: (1) was created by a will of a person who died while a Minnesota resident or (2) became irrevocable at the time the grantor was a Minnesota resident. The taxpayer in the *Fielding* case is the trustee of four irrevocable trusts, which a Minnesota resident created. The trustee filed its state income tax returns, but challenged the constitutionality of Minnesota's current law. The trustee is not a Minnesota resident and does not administer the trusts in Minnesota. Three of the trust beneficiaries are not Minnesota residents. However, the trusts are governed by Minnesota law, hold stock in a Minnesota company, and have one Minnesota beneficiary. The Minnesota Tax Court reviewed the case and agreed the Minnesota law was unconstitutional as applied to this situation.

Analysis of the Case: The Minnesota Supreme Court agreed with the Tax Court, limiting its decision to how the law is applied in this case. A tax satisfies due process if it has a "minimum connection" between the State and the taxpayer, property or transaction at issue, and the income subject to tax is rationally related to benefits the taxpayer received from the State. The Court evaluated the connection of these specific trusts and trustees to conclude a "minimum connection" did not exist and that these trusts cannot be required to pay Minnesota income tax on all income as Minnesota trusts. A few elements of the Court's analysis are worth highlighting:



1. The Court concluded that the grantor's connections to Minnesota "are not relevant" to the relationship between the trusts and benefits that the trusts received from Minnesota. As an analogy, the Court referenced that a child born to Minnesota-resident parents is not automatically taxed as a Minnesota resident for life.
2. The Court found that contacts with Minnesota prior to the tax year at issue were not relevant.
3. The Court said the choice-of-law provision of the trust, which says the trust is governed by Minnesota law, is not enough to tax trusts as residents.

Because the current Minnesota law was found unconstitutional "as applied to" this situation, the law was not struck down, but the government's reach was reduced.

Action Steps: Planning opportunities exist for trustees and individuals as a result of this:

1. Trustees of irrevocable trusts should ask their Gray Plant Mooty attorney about whether this case impacts them. If a trust's relevant contacts with Minnesota during a prior tax year are insufficient to permit Minnesota to tax the trust's income, the trustee may be able to amend prior Minnesota income tax returns to request a refund.
2. Individuals who have the power to change the trustee of an existing irrevocable trust may want to evaluate whether to change trustees to a non-Minnesota trustee, which could include naming an existing trustee's office in a different state. Depending on the other facts of your specific situation, if a trustee change could lead to not paying Minnesota income tax, it may be worth considering.

This case is consistent with rulings in other states across the country. As a result of the Court's decision, the Minnesota legislature might take action to revise the tax law. Please call your Gray Plant Mooty attorney if you have questions or want to discuss opportunities that these changes might present for your situation.