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Due Process, State Taxation of Trusts and the Myth of the Powerless Beneficary: A Response to Bridget Crawford and Michelle Simon

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ABSTRACT

This piece takes issue with Bridget Crawford and Michelle Simon's argument in their article about the recent Supreme Court case North Carolina Department of Revenue v. Kaestner Family Trust (argued May 16, 2019) (The Supreme Court, Due Process and State Income Taxation of Trusts (67 UCLA L. REV. DISC. 2 (2019)). First, plaintiff Kimberly Rice Kaestner was not, as Crawford and Simon (and the Trustee) claim a "contingent beneficiary" (the "powerless beneficiary" of my title), meaning that any distributions she might receive were wholly dependent on the trustee's decision and were beyond her control. This is not correct—the trustee's discretion was hemmed in by many factors, in both the law and in the trust instrument itself, which gave Kaestner rights to the assets. Second, Crawford and Simon support the trust's argument that North Carolina had no jurisdiction to tax the trust. The issue of the state's jurisdiction over the trust, however, asks the wrong question, throwing out a red herring. The real question is whether the state has jurisdiction to tax Kaestner, the beneficiary, on the trust income she benefitted from while she lived in the state. As I show, she did benefit from her trust income during this time, and in significant ways. Allowing a state to tax a resident on income they benefit from is perfectly consistent with due process. Ultimately, this case is an opportunity for the Court to see through the sleight of hand of the trust's title split—by which it places legal title in the trustee and beneficial title in the beneficiary. This a sleight of hand has created too many tax shelters for the wealthy, helped deplete the public fisc, and undermined tax equity.

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INTRODUCTION

> "Why, sometimes I've believed as many as six impossible things before breakfast."[1]

The quote from Pudd'nhead Wilson's New Calendar Crawford and Simon use to head their article—"Truth is stranger than fiction, but it is because Fiction is obliged to stick to possibilities; Truth isn't"—is perfectly appropriate for a piece about trust law.[2] In fact, it is a perfectly appropriate heading for an article about this particular trust law case. This is true because trusts are designed to obscure reality—the reality of the beneficiary's property power—and to separate the enjoyment of property from the moral and legal obligations that normally attach to it, including paying taxes. What is at stake in the *Kaestner* case is the trust's sleight of hand, and the Court's ability to see through it. Therefore, I have matched Crawford and Simon's quote with one of my own about reality and perception.

To agree with the trustee's position in this case, one must believe many impossible things. One must believe that a beneficiary receives no benefits from a thirteen-million-dollar trust set up specifically for her benefit, of which she and her children are the only beneficiaries, to which she at all times had access to request funds, and from which she borrowed large sums to make investments—without paying them back from her assets. In an example from another case, one must believe—as that court did—that a beneficiary who receives monthly checks for two years totaling $800,000 in distributions from the trustees, who are the beneficiary's brother and the family attorney, but whose checks mysteriously stop on the eve of the divorce has merely a "speculative" interest and no certainty of receiving money from the trust ever again. This sleight of hand ensured that no part of the trust income was marital property to be divided equitably upon divorce.[3] Or, in another case, one must believe that a trust beneficiary whose brother, the trustee, changes the terms of the trust shortly after the divorce to make his distributions purely discretionary, has no intent to deprive his former spouse of marital assets.[4] To believe that the beneficiary in *Kaestner* should not pay taxes on her share

1. LEWIS CARROLL, THROUGH THE LOOKING-GLASS AND WHAT ALICE FOUND THERE 207 (1871).
2. Bridget Crawford & Michelle Simon, *The Supreme Court, Due Process and State Income Taxation of Trusts*, 67 UCLA L. REV. DISC. 2, 2 (2019).
3. *See* Pfannenstiehl v. Pfannenstiehl, 55 N.E.3d 933 (Mass. 2016).
4. *See* Ferri v. Powell-Ferri, 72 N.E.3d 541 (Mass. 2017).

of trust income, distributed or not, is to believe at least one impossible thing, perhaps before breakfast. One must believe in the myth of the powerless beneficiary.

That myth of the powerless beneficiary was born of the title split. Because the trustee has exclusive legal title, the beneficiary can argue that she is at his mercy. As a technical matter, because of the title split, the beneficiary cannot write checks, sell trust assets, or make investment decisions. She thus may appear to be helpless, with no power to access the trust's wealth. This myth, however, is often just that—a fiction that serves a purpose. It is a fiction for two reasons. First, the reality in most family trusts like the one here is that the sole purpose of the trust is to benefit the beneficiary, who is usually a child or grandchild of the grantor. Typically, the trust instrument makes clear—as does the one here—that very little should stand in the way of her receiving distributions. Second, it is a fiction because even undistributed assets confer property power on the beneficiary. By property power, I mean the chance to make choices and take opportunities that are unavailable to other people. Kaestner's property power enabled her to become a significant economic actor in the state, easily establishing the purposeful availment required for due process. In addition, she had a trust with a spendthrift clause that shielded her from the costs of her potential actions, and would shift them to state taxpayers. For all these reasons, the state has jurisdiction to tax her.

Kaestner is the first trust tax case the Court has decided in over sixty years. It presents an important chance to revisit norms of trust taxation, which have gone unquestioned for decades. It offers the opportunity to curtail tax evasion by trust beneficiaries, a reform that is long overdue. It is critical to understand exactly what is at stake here—can tax law continue let the trust's title split blind it to the reality of the beneficiary's economic power? Or should trust taxation be more realistically based on the fundamental principle that one pays taxes on property one benefits from? In brief, this case offers a chance for the Supreme Court to stop believing the impossible and to dismantle some of the myths of the trust for the sake of the public fisc and tax equity. In so doing, it can close an egregious tax shelter and respect state taxing authority.

Crawford and Simon—and the trustee—urge the Court to find that the state has no constitutional authority under the Due Process Clause to tax trust income when the trust's only connection with the forum state is the residence of a beneficiary whose interest they label as "contingent."[5] They cite a long line of due process tax cases in support of this position. My response is twofold—first, the inquiry about the state's jurisdiction over the trust is misplaced, and is in fact a red herring. The trust is not being taxed in this case; what is being taxed is the beneficiary's share of trust income—thus, the beneficiary. While Crawford and Simon correctly state that an irrevocable trust is taxed as an entity, this is only true as long as it does not make distributions to the beneficiaries. Because undistributed assets remain in the trust, the trustee, who manages the trust, must remit the taxes. The trustee does not remit the taxes from his assets. The taxes are paid out of trust property, with cash that will ultimately come out of the beneficiaries' shares. The taxes come from the beneficiary's interest in the trust.

Taxing the beneficiary in this case is entirely consistent with the basic principle of tax law that a person who controls and receives benefit from income should pay taxes on it. The real question here is whether the beneficiary controlled, and received enough benefits from, her trust income while she lived in North Carolina to pay state income taxes on it. The trustee by definition is barred from enjoying any beneficial interest in the trust property—the only person who may receive beneficial interest is the beneficiary. If and when the beneficiary receives the benefits of trust income, she should pay the corresponding tax in her state of domicile. This is uncontroversially consistent with due process. The trustee here makes ample use of the myth of the powerless beneficiary by trying to direct all eyes to the trust in the question of tax jurisdiction. But the Court need not fall for this sleight of hand.

This brings me to Crawford and Simon's second major point. They assert that the fact that the beneficiary did not receive distributions from the trust while in North Carolina means the state cannot tax her proportionate share of trust income. I argue that the mere fact that the trustee did not literally write checks to the beneficiary does not mean she failed to benefit from her share of trust income or control it for tax purposes. First, as discussed below, the record shows that her interest in the trust alone, even without distributions, allowed her to benefit from her share of trust income, in ways that should subject her to taxation in the state. Second, the beneficiary requested that the trustee not make distributions to her during the relevant

5. The Commerce Clause arguments were dropped by the time the case reached the Supreme Court.

period. Under tax law, her power to decline distributions showed she had control over them, and thus was required to pay income taxes.

Part I of this Article highlights key facts of the case.[6] Part II explains the trust's sleight of hand in making the beneficiary's power disappear, and shows how it has achieved this throughout the history of the trust. Part III analyzes the language of the Kaestner trust to show that the beneficiary actually had access to the funds. Part IV then explains how Kaestner derived property power from the trust's assets even without receiving actual distributions. Finally, I conclude with some thoughts about tax equity and inequality which this case implicates.

I. THE HISTORY OF THE CASE

On December 30, 1992, Joseph Lee Rice III created three trusts, one for the benefit of each of his three children and their issue.[7] A single trust instrument governed all three trusts.[8] (The end-of-year timing itself suggests sophisticated tax planning.)[9] The trust instrument states that New York law governs the terms of each separate trust.[10]

When he established the trust, Mr. Rice and the trustee were domiciled in New York.[11] Because of this, the trust was subject to income taxation in the state of New York.[12] In 1995, Mr. Rice moved to Florida.[13] In 1997, Kimberley Rice Kaestner, Mr. Rice's daughter and a beneficiary of one of the three trusts, moved to North Carolina.[14] During the tax years in question, 2005 through 2008, she lived there, raised her children there, and earned degrees from North Carolina State University.[15] According to the terms of the trust, it was

6. For a detailed explanation of the facts and procedural history of the case, see Crawford & Simon, *supra* note 2, at 6–10.
7. Complaint ¶¶ 11–12, 14, 17, Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, No. 12 CVS 8740 (N.C. Super. Ct. Apr. 23, 2015), 2015 WL 1880607 [hereinafter Complaint], *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.).
8. *Id.* ¶¶ 11, 17.
9. Susan Gary, et al, CONTEMPORARY TRUSTS AND ESTATES at 740 (3d ed. 2017) (explaining annual exclusion).
10. *Id.* ¶ 15.
11. *Id.* ¶ 13.
12. *Id. See also* N.Y. TAX LAW § 605(b)(3)(D) (McKinney 2018) (imposing income tax based on residence of trustee in New York).
13. Complaint, *supra* note 7, ¶ 16.
14. *Id.* ¶ 17.
15. Joint Appendix at 81, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (No. 18-457), 2018 WL 7469782 [hereinafter Joint Appendix] (deposition of Kimberly Rice Kaestner).

up to the trustee's discretion to distribute income from the trust to Kaestner, and he did not distribute income to her directly.[16] During that time, however, Kaestner took out loans from her trust to invest in a business in the state and to cover a capital call on a limited partnership interest held in another trust.[17] These loans were paid back by another trust.[18]

The trust agreement directed the trustee to distribute all of the separate share trust property to Kaestner upon her attaining the age of forty on June 2, 2009.[19] At this time, she chose not to receive the trust assets but rather to have them put in another trust.[20]

North Carolina imposes an income tax on any trust for the benefit of a North Carolina resident.[21] This is the case whether the beneficiary actually receives distributions from the trust or not. The statute reads as follows:

> The tax imposed by this Part applies to the taxable income of estates and trusts as determined under the provisions of the Code except as otherwise provided in this Part. The taxable income of an estate or trust is the same as taxable income for such an estate or trust under the provisions of the Code, adjusted . . . between the estate or trust and the beneficiaries based on the distributions made during the taxable year. The tax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State . . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.[22]

As the statute makes clear, it taxes the income of a trust which is "for the benefit of" a beneficiary living in the state, and it taxes only that beneficiary's share of the trust's income. Likewise, the statute imposes a tax on trust income which is "derived from North Carolina sources," "attributable to the

16. Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, No. 12 CVS 8740, 2015 WL 1880607, at *2 (N.C. Super. Ct. Apr. 23, 2015), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.); Complaint, *supra* note 7, ¶ 23.
17. Kaestner, 2015 WL 1880607, at *2.
18. Joint Appendix, *supra* note 15, at 87–88 (deposition of Kimberly Rice).
19. *Id.* at 47 (affidavit of David H. Bernstein).
20. *Id.* at 98-102 (deposition of David H. Bernstein).
21. N.C. GEN. STAT. ANN. § 105–160.2 (West 2017).
22. *Id.*

ownership" of property in the state, or "derived from a business, trade, profession, or occupation" in the state. The theme connecting these three categories is that individuals or businesses that derive benefits from the state's services and infrastructure should pay for these benefits by paying their fair share of taxes. This is the basic principle underlying state income tax.

II. THE TITLE SPLIT'S SLEIGHT OF HAND, PRESENT AND PAST

The technicality of title split cannot be allowed to obscure the fact that the trust benefits the beneficiary and not the trustee. It is misleading to speak of the trustee as "owning" the trust assets, as counsel for the respondent did at oral argument.[23] The concept of ownership at common law usually refers to a bundle of rights, including the rights to enjoy, use, transfer, and exclude others.[24] The trust relationship splits these usually aggregated rights into two bundles: one, the legal rights, which attach to the trustee who manages and distributes the property, and two, the equitable rights, which include the right to enjoy and use the property for one's personal benefit.[25] The trustee is absolutely forbidden to derive any personal benefit from the trust assets; her only role is to manage them in the best interests of the beneficiary.[26] Thus, it makes no sense to speak of taxing the trustee. People do not pay taxes on property they manage for the benefit of others.

The trust here tries to divert attention from the beneficiary by focusing on jurisdiction to tax the trust itself, or the trustee.[27] This argument attempts to draws a sharp line between distributed income, which, everyone agrees, is taxed to the beneficiary as income, and undistributed income, which, the trustee argues, should be deemed taxed to the trust when a state has jurisdiction purposes. Thus, the trustee's arguments here for the most part address whether the state of North Carolina taxing the Kaestner Trust comports with due process. As I note above, however, this is the wrong question. The state has jurisdiction to tax Kaestner, its resident, and should do so in this case because, as I will show, the trust instrument gives her access

23. Transcript of Oral Argument at 33–34, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (No. 18-457).
24. *See, e.g.*, Anna Di Robilant, *Property: A Bundle of Sticks or a Tree?* 66 VAND. L. REV. 869, 877–78 (2013) (discussing origins and evolution of bundle of sticks model).
25. *See* Kent D. Schenkel, *Trust Law and Title Split: A Beneficial Perspective*, 78 UMKC L. REV. 181, 185–91 (2009) (discussing the evolution of the title split fiction).
26. RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. b (AM. LAW INST. 2019).
27. Brief for the Respondent at 1, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (No. 18-457).

to and control of her share of trust assets. More importantly, the trust gives her financial agency. First, the terms of the trust give the beneficiary sufficient control over the income distributions for taxation purposes, and, second, even income which is technically undistributed, nonetheless benefits the beneficiary to an extent sufficient for taxation.

This red herring of trust entity taxation goes back at least to the Revenue Act of 1916 and the Securities Exchange Act of 1934.[28] Characterizing the trust as an entity allowed taxation of the undistributed income. Ironically, the entity taxation of trusts portions of these two laws were attempts to curtail tax evasion that occurred when income accumulated in the trust and was not distributed.[29] The Restatement (Third) of Trusts (2003) acknowledges the increasing recognition of "the trust as a legal 'entity,' consisting of the trust estate and the associated fiduciary relation between the trustee and the beneficiaries."[30]

This characterization is misleading for tax purposes because it creates confusion about who is being taxed. In substance, the taxes come out of the beneficiary's income, because the beneficiary is the one who will receive the income (or the remainder, or whatever interest the beneficiary has). Taxing the trust as an entity is just an efficient way of making sure that taxes on undistributed income get paid. But it is no different from taxing the beneficiary directly, as North Carolina has chosen to do. This confusion about who is actually paying taxes, trust or beneficiary, leads to taxing the trust on the basis of the due process analysis that applies to taxing corporations, examining the trust's contacts and "purposeful availment" of the forum state. This makes little sense. It ignores the fact that the person who benefits from the trust assets is the beneficiary, not the trust, nor the trustee. This argument falls for the trust's sleight of hand, tricked into looking at the trustee's legal title over the trust's assets, and not at the person who benefits from them. Standing alone, the trust assets are not the trust. Without the fiduciary relationship of the trustee and the beneficiaries, they are merely a collection of assets, apportioned in some way among a range of beneficiaries. Taxing these assets in reality means taxing the beneficiaries who will ultimately receive them, and not the trust itself. Thus, it comports perfectly with due process for a state to tax a resident beneficiary for trust income, even if it is undistributed.

28. Georgine M. Kryda, *Trusts as Entities Under Restatement (Third): A Conceptual Framework for Drafting—Part 1*, 45 APR COLO. LAW. 45, 47 (2016).
29. *Id.*
30. RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. a (AM. LAW INST. 2019).

This is because the trust assets, whether distributed or not, give the beneficiary "property power."[31] "Property power" refers to the social and material goods that access to wealth confers. As I will explain, the beneficiary of the Kimberley Rice Kaestner Trust derived many advantages from the trust even though she received (at her request) no distributions from it. Because the advantages she received were artificially separated from the normal obligations attaching to property ownership through the form of the trust, they imposed costs on the state of North Carolina and its citizens. The beneficiary lived in North Carolina and derived advantages from the state such as schools, fire and police protection, roads, and banking. Due to her access to trust property, she did not have to work, and thus avoided taxation on wages, benefitting from state serviced without paying for them. Because of this, the state had jurisdiction to tax her. This logic makes it straightforward to apply the traditional tax jurisdiction maxim "mobilia sequunter personam" to trust assets by attaching them to their beneficial owner. Pointing to the trustee, who derived no advantages from the trust assets, as the party to be taxed, is merely throwing out a red herring,

The trust was not invented to disempower the beneficiary. To the contrary, the history of the trust makes clear that its purpose was to obscure the reality of the beneficiary's property power and to avoid the legal obligations—or in some cases the moral opprobrium—normally attaching to property ownership. One of the earliest trusts in English law were those benefitting the Franciscans, who were sworn to poverty.[32] Their poverty oath made life difficult, even unpleasant. The solution appeared in the form of the use—a device which allowed a benefactor to vest legal title in a trustee "ad opus franciscanorum" (for the use of the Francisicans).[33] This allowed the Franciscans to enjoy the benefits of the property by having comfortable places to sleep, meals, housing and money for travel, without technically breaking their vows. They could argue that they did not legally "own" the property they were b32enefitting from.

The use spread to other sectors of society because it was also a useful way to avoid feudal dues—in modern terms, taxes.[34] When property passed to an heir, it triggered dues to the feudal overlord.[35] To circumvent this, the

31. *See* Roger Cotterell, *Power, Property and the Law of Trusts: A Partial Agenda for Legal Scholarship*, 14 J.L. & SOC'Y 77 (1987).
32. A.W.B. SIMPSON, A HISTORY OF THE LAND LAW 174 (2d ed. 1986).
33. Avisheh Avini, *The Origins of the English Trust Revisited*, 70 TUL. L. REV. 1139, 1144 (1996).
34. SIMPSON, *supra* note 32, at 174–75.
35. *Id.* at 182.

decedent would transfer title to a group of people as "foeffees"—trustees—to hold as joint tenants with a right of survivorship for the heir to use the property.[36] Because of the law of joint tenancy, when one foeffee died, his interest would accrue to the remaining joint tenants and no estate would pass on to his heirs.[37] Because no property descended, there were no dues to pay.[38] The use also offered an opportunity for simple fraud—a person planning to commit treason, for example, could transfer title to his property to foeffees, thus avoiding forfeit to the crown and allowing him to pass it on to his heir.[39] These maneuvers functioned quite well for several centuries, until Henry VIII caught on and tried to stop it with the Statute of Uses.[40] The point is, none of these title splitting devices undermined the property power of the beneficiary. They actually increased it by separating it from the legal and moral obligations it normally carried.

III. THE LANGUAGE OF DISCRETION AND THE MYTH OF DISCRETION

The Kaestner trustee claims that because the trust gave him complete discretion with regard to making distributions, the beneficiary's interest in the trust assets was contingent, meaning dependent on the occurrence a condition precedent—the trustee's decision to distribute.[41] Because of his discretionary power, the trustee argues, Kaestner had no property interest in the assets before this event occurred and therefore could not be required to pay taxes in them. In Crawford and Simon's words: "Taxation would hinge on the possibility that a trustee might make a discretionary decision to make a distribution from the trust, when the beneficiary has no control over this decision."[42] This argument is problematic in several ways.

Most importantly, this argument ignores the very essence of donative trusts—they are set up for the sole purpose of benefitting the beneficiary.[43] The beneficiary's welfare and access to the trust resources is the sole reason for the trust's existence; without a beneficiary there would be no reason to

36. *Id.* at 173.
37. *Id.* at 183.
38. *Id.*
39. *Id.* at 174.
40. *Id.* at 184.
41. Brief of American College of Tax Counsel as Amici Curiae in Support of Petitioner at 8, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (No. 18-457).
42. Crawford & Simon, *supra* note 2, at 16.
43. Kent D. Schenkel, *Exposing the Hocus Pocus of Trusts*, 45 AKRON L. REV. 63, 118 (2012).

establish a trust relationship.[44] Regardless of whether or not she received literal distributions from the trust, the reality is that Kaestner lived off the trust assets indirectly throughout her time in North Carolina. Despite receiving a bachelor's degree in history and a master's in education and school counseling from the University of North Carolina, the record contains no evidence that she worked in those fields, or in any others.[45] The record fails to indicate whether she worked at all. She did, however, invest in businesses with the support of the trust—she borrowed $250,000 from the trust to invest in a local business; the loan was paid back, but not by Kaestner—rather, it was paid by another family trust.[46] In effect, then, the $250,000—plus the interest—was a distribution to Kaestner. Her extensive economic activity reveals the background existence of what I have been calling the "property power" emanating from the trust. Even without receiving actual checks from the trust, Kaestner's life decisions were based on access to thirteen million in wealth. She was able to make choices and take investment opportunities unavailable to others.

Moreover, Kaestner could have made millions as the trust assets accumulated during her residence in North Carolina, precisely because she declined distributions.[47] During this period, the trustee made decisions about the trust's investments which benefitted Kaestner.[48]

In light of these facts, it should be clear that a beneficiary of a discretionary trust has more than a merely a contingent interest, as the Kaestner Trust argues. A contingent beneficiary is one who becomes a beneficiary, if at all, due to the occurrence of an event—a condition precedent—which may or may not occur. For example, a trust could state that A will become a beneficiary if she outlives B (in fact, the Kaestner Trust has just such a clause in Article Third). As established above, Kaestner was not a contingent beneficiary of this trust; she was a current, discretionary beneficiary during the trust's existence.

The discretionary beneficiary's interest, in contrast to a contingent one, is not subject to a condition precedent. While the trust argues that, because

44. *See generally id.*
45. Joint Appendix, *supra* note 15 at 81 (deposition of Kimberly Rice Kaestner).
46. Defendant-Appellant's Reply Brief at 3, Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue, 789 S.E.2d 645 (N.C. Ct. App. 2016) (No. COA15-896), *aff'd*, 814 S.E.2d 43 (N.C. 2018), *cert. granted*, 139 S. Ct. 915 (2019) (mem.), (No. 18-457).
47. For further discussion on how Kaestner could have directly benefitted financially from the trust, see Petitioner's Reply Brief at 20–21, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (No. 18-457).
48. Joint Appendix, *supra* note 15, at 93 (Deposition of David Bernstein, May 2, 2014).

the trustee had "absolute discretion" to decide whether and how much to distribute, his decision to do so is a condition precedent to the beneficiary acquiring a property interest in the trust.[49] However, this is not the case. While this law, like hell, is murky,[50] all authorities agree there is no such thing as completely unfettered discretion in a trustee. While it is true that a beneficiary of a discretionary trust has no interest which could be called "vested," her right is "more than a mere spes."[51] As Lewin explains, a beneficiary of a discretionary trust has several rights with respect to the property:

> [he] has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity . . . when it is said that he has a right to have the trustees exercise their discretion "fairly" or "reasonably" or "properly" that indicates clearly enough that some objective consideration [not explicitly stated in the trust] must be applied by the trustees.[52]

The property rights of a discretionary beneficiary include: the right to be considered for the exercise of the trustee's discretion, the right to demand an accounting from the trustee, and the right to bring a claim for breach of fiduciary duty.[53] The beneficiaries can do this even without the trustee having made a decision to distribute to them—in fact, his very decision *not* to distribute to them might be grounds for suing.[54] This proves that the decision to distribute is not a condition precedent; if it were, the beneficiary would have no right to sue before it occurred. As Judge Learned Hand put it, "No language, however strong, will remove any power held in trust from the reach of a court of equity."[55] And the Restatement (Third) warns that "words such as 'absolute' or 'sole' and 'uncontrolled' or 'unlimited' are not interpreted literally."[56]

The trustee has the duty to act in good faith and to inquire as to the beneficiary's needs in making distribution decisions. Several cases bear this out. In *Marsman v. Nasca*, the court held that a trustee holding a discretionary power to pay principal for the "'comfortable support and

49. Respondent's Reply Brief at 45, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (No. 18-457).
50. WILLIAM SHAKESPEARE, MACBETH act 5, sc. 1.
51. LYNTON TUCKER ET AL., LEWIN ON TRUSTS 30 (19th ed. 2015).
52. *Id.*
53. *Id.*
54. *See infra* text accompanying notes 62–69.
55. *A Trustee's Duty to Inform and Account*, 37 EST. PLAN. 44, 45 (September 2010).
56. RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c (AM. LAW INST. 2019).

maintenance' of a beneficiary . . . [violated his] duty to inquire into the financial resources of that beneficiary so as to recognize his needs."[57] Stating that "discretion is not absolute," the court found that the trustee's failure to inquire and to distribute funds which would have allowed the beneficiary to keep his home was a breach of duty, and imposed a constructive trust on the remainder in the trust in favor of the beneficiary's estate after death.[58] *Marsman* is routinely cited for the rule that a discretionary trustee has duties to the beneficiary.[59]

The trustee's discretion is even more limited when the trust contains other instructions about distributions, as did the Kaestner Trust. While stating that the trustee had absolute discretion, the trust instrument in other places makes clear that this discretion is limited. For example, Article 1.4(b) requires the trustee to consider only the needs of the beneficiary who is being considered for a distribution at the time, and bars him from taking into account "the interests of any other person who may at any time be or become interested in [the trust]."[60] In Article 1.4(c), the trust directs the trustee to "be liberal in the exercise of [his] discretion" and to use up to all of the assets of the trust "to meet the needs of the Beneficiaries, including, without limitation, to provide for their health, education and Welfare, to purchase or provide a home for them, and to aid then at the time of marriage or in setting up a business," without consideration for any future beneficiaries of the trust.[61]

These additional instructions hem in the trustee's discretion and make clear that the beneficiaries have more than an expectation (a "spes") in the property. They have a right to ask a court to require the trustee to make distributions if they feel that he is ignoring or violating these additional instructions. This is because the grantor's intent is the most important consideration for trust enforcement. The settlor's intent limits the discretion of the trustee. The whole of the trust instrument will be read to indicate the grantor's intent, and can place limits on a trustee's discretion even when that discretion is "absolute." For example, in *In re Van Dusen Marital Trust*, a husband left a trust for his widow with regular income payments and instructions that they "may" distribute as much of the principal as they "deem advisable to provide for her health, education, support, maintenance and

57. Marsman v. Nasca, 573 N.E.2d 1025, 1027, *rev. denied* (Mass. App. Ct. 1991).
58. *Id.* at 1030–31.
59. *See. e.g.*, Frances Foster, *Trust Privacy*, 93 CNLLR 555, 605 n. 379 (2008).
60. Joint Appendix, *supra* note 15, at 50–51 (Trust Instrument 1.4.b).
61. *Id.* at 51 (Trust Instrument 1.4.c).

care."[62] The widow brought suit when the trustees repeatedly denied her requests for distribution of principal, but the district court ruled that the trustees had simply exercised the discretion the trust instrument gave them.[63] However, the appeals court reversed, ruling that "a trustee may not exercise its discretion in a manner that defeats the grantor's intent."[64] It went on to say that "even if the trustees have 'absolute, unlimited, or uncontrolled discretion, any attempt to violate the settlor's intent or the trust's purpose is an abuse of discretion.'"[65] The grantor's intent will be determined from a reading of the instrument as a whole, and if it contains other indications of intent that limit the "absolute discretion" conferred, those wishes will bound that discretion. The *Van Dusen* court held that the trustees had abused their discretion in denying the requests for distribution of principal, because the instrument, as well as the discretionary language, contained other language indicating the grantor wished the trustees to use the principal "liberally . . . to enable [the widow] to maintain . . . the standard of living to which she was accustomed."[66]

Applying this analysis to the Kaestner trust makes clear that the beneficiaries had more than a mere contingent interest in the trust income. Based on nothing more than the absolute discretion granted to the trustee, they would have had the right to sue for breach of fiduciary duty if the trustee failed to inquire about their needs, or made distribution decisions that were arbitrary or capricious. The additional expressions of the grantor's intent, however, further limited the trustees' ability to deny distributions if one of them wanted to marry or start a business, for example. In addition to the examples of the limiting language above, Article 1.4 (b) orders the trustee to "consider only the interests of the person or persons for whom it is deemed advisable to use income or principle and not the interests of any other person who may at any time be or become interested in any trust hereunder."[67] In other words, the trustee had no duty to try to preserve assets for any future beneficiaries, or account for the needs of any beneficiary other than the one in need of funds at the moment. This clause further limits the trustee's discretion by disallowing trust preservation as a basis for refusing distributions.

62. In re G.B. Van Dusen Marital Trust, 834 N.W.2d 514, 518 (Minn. Ct. App. 2013).
63. *Id.* at 521.
64. *Id.* at 524.
65. *Id.*
66. *Id.* at 518.
67. Joint Appendix, *supra* note 15, at 50–51 (Trust Instrument 1.4.b).

Tax law also supports the conclusion that the beneficiary here had sufficient power over her share of trust income to be considered in control of it for tax purposes. The language of paragraph 1.c instructing the trustee to be liberal in distributing both income and principal for the beneficiaries' "health, education and welfare" and to "provide a home for them, and to aid them at time of marriage or in setting up a business" creates what is called in tax terms an "ascertainable standard."[68] This is an objective standard that will be enforced by a court. Ascertainable standards arise in the context of estate taxes—often a grantor puts property in trust as a way to remove it from the calculation of the value of her estate at death. If the grantor retains the right to determine who will receive the assets in the trust, she will be deemed to have retained control, and the trust assets will be included in her gross estate. An ascertainable standard is one way to avoid this outcome; if the trust instructs the trustee to distribute funds to a beneficiary for her "health, education and welfare," the gift is considered complete because the beneficiary can successfully force a distribution that falls within that standard.[69]

Much of the language in paragraph 1.c of the trust embodies an ascertainable standard. Under trust law, this language would give the beneficiaries the right to sue the trustee for abuse of discretion if he failed to make distributions under these terms. In tax law, these terms take the trust assets out of the control of the trustee and give the beneficiaries an enforceable right to force distribution of the assets.

IV. PROPERTY POWER

Legal regimes other than trust law and tax law would also recognize Kaestner's interest in the trust as a property right. For example, courts equitably dividing marital property have determined interests in trusts like Kaestner's to be property in which the spouse beneficiary had an interest sufficient to make it part of the marital estate. In *Comins v. Comins*, the wife had an interest in a trust settled by her father very similar to Kaestner's—the trustee had discretion to "pay to the wife so much or all of the income and principal of the trust as in its discretion it deems advisable to provide for comfort, welfare, support, travel and happiness" of the wife.[70] Like Kaestner,

68. *Id.* at 51. *See* STEPHANIE J. WILLBANKS, FEDERAL TAXATION OF WEALTH TRANSFERS: CASES AND MATERIALS 255–63 (4th ed. 2016).
69. *See id.* at 255.
70. Comins v. Comins, 595 N.E.2d 804, 806 (Mass App. Ct. 1992).

the wife in *Comins* chose not to receive distributions but rather "to reinvest all the income and capital gains produced by the trust corpus . . . for the benefit of the parties' children."[71] Despite this fact, the court recognized that the couple together relied on and derived property power from the trust assets.[72] It noted that the trust "provided the parties with a substantial insurance policy against economic hardship and also permitted them to direct their other marital assets, such as the husband's salary, to the maintenance of a higher standard of living than their earned income allowed."[73]

The judge in *Comins* recognized the property power derived from trust assets even when they are not distributed to the beneficiaries. The wife, like Kaestner, benefitted from the trust despite not receiving any distributions. Both were able, as Justice Kagan noted at oral argument, to make different life choices because they always had the trust assets behind them.[74] Neither had to save for retirement, college tuition, illness, or job loss.[75] They could spend all they earned on maintaining "a higher standard of living than their earned income allowed."[76] The trust assets, sitting untouched, gave them a higher standard of living than they would have had without them.

The oral argument transcript reveals that Justice Kagan understands the idea of property power. She notes that Kaestner saw "a substantial asset of hers increase in value" while she lived in North Carolina, which is "influencing her life choices because she knows she's eventually going to enjoy that money."[77] She goes on to question why Connecticut, the residence of the trustee, should have jurisdiction to tax the trust income since "the trustee is not going to be the beneficiary of that income growth."[78]

If indeed Kaestner was not employed during the tax years in North Carolina, she likely did not pay any income tax on wages. If this is true, the trust assets allowed Kaestner to be an economic actor in the state and benefit from its business infrastructure without paying any income taxes. The basic idea underlying taxing the income of state residents is that they benefit from the state's infrastructure, as Kaestner clearly did in many ways. She attended a highly ranked state university and paid in-state tuition, and she benefitted from the state's police and other emergency responders, as well as local

71. *Id.* at 807.
72. *Id.*
73. *Id.*
74. Transcript, *supra* note 23, at 36.
75. *Id.*
76. Comins, 595 N.E.2d at 807.
77. Transcript, *supra* note 23 at 36.
78. *Id.* at 39–40.

infrastructure such as roads. More importantly, the trust's assets allowed her to invest in and benefit from a state business, thereby benefitting from the state's regulatory system and business incentives. As Justice Kagan observes, "the only state that can't tax her income is the state that is providing services to the person who's going to benefit from this income growth."[79]

The fact that Kaestner could decline distributions—as the record clearly shows—also indicates her control. In an analysis applicable to trust interests, the Supreme Court in *Drye v. United States* recognized that having the choice to disclaim a property interest indicates the existence of a property right.[80] Although *Drye* involved a federal tax lien, its logic is illuminating for this case as well. The defendant in *Drye* owed federal taxes and declined to accept an inheritance because the Internal Revenue Service would have taken it.[81] While he argued that his disclaimer of the inheritance was akin to rejecting a gift, Justice Ginsberg differentiated the two because of the degree of control exercised in the disclaimer.[82] While rejecting a gift merely "restores the status quo," a disclaimer "channels" the property in a definite direction, one which may still benefit the beneficiary.[83] In *Drye*, the taker in default was the disclaimant's daughter; here, when Kaestner declined distributions, she "channeled" the assets' growing worth to herself and her children. In both cases, the person who rejected the distribution in effect controlled where the money would go. The investments continued to accrue to Kaestner's own future benefit. The reality is that her decision not to receive distributions during the tax years at issue increased the benefits she would actually ultimately receive from the trust.

The fiction of title split has regularly blinded courts to the reality—the property power—of trusts. As I noted earlier, title split was never intended to disempower the beneficiary.[84] To the contrary, it actually empowered the beneficiary by relieving him of the obligations which normally attend on property ownership while leaving him with the full enjoyment of the assets. Courts seem especially oblivious to this in the case of family trusts, leading to inequitable results. Two recent Massachusetts cases offer clear examples of this.

79. *Id.* at 44.
80. Drye v. United States, 528 U.S. 49 (1999).
81. *Id.* at 53.
82. *Id.* at 51.
83. *Id.* at 60–61. *See also* Schenkel, *supra* note 43, at 114.
84. *See supra* notes 32–33 and accompanying text.

Ferri v. Powell-Ferri, addressed the divorce of Paul Ferri and Nancy Powell-Ferri, who were married in 1995.[85] Paul was the sole beneficiary of a trust settled by his father. Shortly after the filing for divorce, the trustees, one of whom was Paul's brother, decanted the original trust into a new trust, the 2011 trust, which lacked any provision allowing Paul to demand payment of trust assets.[86] Previously, Paul had the right to claim up to 75 percent of the trust assets, and over the course of the divorce action, this interest matured into a right to claim 100 percent.[87] The "new" trust gave him no such right.[88]

Despite the fact that one of the trustees was Paul's brother, and the change in the form of the trust had been made "out of concern that [Nancy] would reach [its] assets as a result of the divorce action."[89] The court let the title split blind it to the reality of Paul's property power. The court accepted that Paul did "not have a role in creating the 2011 trust,"[90] and that the trustees acted "without informing the beneficiary and without his consent."[91]

Because of the title split, the court could assert that the brother-trustee could deplete the marital estate without crediting any of the intent to do so to the beneficiary. Clearly, there was an intentional depletion of the estate Nancy may have been entitled to, for Paul's benefit, but because Paul's brother, acting as trustee, rather than Paul, did it, the Court deems Paul powerless.

This makes little sense. One of the reasons Massachusetts courts may treat trust assets as part of the marital estate upon divorce is that they recognize the reality of property power and see through the screen of title split. In not doing so, the *Ferri* court allowed for an inequitable definition of marital property to prevail. It could only do this by ignoring the reality that the trustee was the beneficiary's brother and unlikely to do anything without his complicity, whether there was a record of it or not. The title split blinded the court to the material reality of the trust, which was that Paul was going to continue to get distributions from the trust, and that the terms of the new trust were not going to change that.

To make the illogic of this case clearer, consider a slightly changed set of facts. Suppose Paul was happily married and had been benefitting from this trust. He had reached the age where he had a right to withdraw 75 percent of the trust assets. The trustee calls Paul to tell him that he recently decanted the

85. Ferri v. Powell-Ferri, 72 N.E.3d 541, 543–44 (Mass. 2017).
86. *Id.*
87. *Id.*
88. *Id.* at 549.
89. *Id.* at 544.
90. *Id.* at 552 (Gants, C.J., concurring).
91. *Id.* at 544.

trust into a spendthrift trust and that Paul no longer has withdrawal rights in the new trust. Paul was planning to make a large withdrawal from the trust later in the year to build his family's dream home. Paul sues the trustee for breach of fiduciary duty. Does he win? Very likely—the trustee completely ignored the settlor's intent—to make the trust assets available to Paul at a certain age. This change in facts highlights the reality the *Ferri* decision's fallacy, and the reality of the beneficiary's property power. Clearly, if the trustee had made any changes to the trust that went against Paul's wishes and the clear intent of the trust, Paul would have sued him for breach of fiduciary duty, and won. The trustee's act in decanting the trust had to have been done with Paul's implicit consent.[92]

This reality reveals the beneficiary's property power behind the screen of the title split; the trustee of a discretionary family trust like the ones at issue here is not going to bar the beneficiary's access to the assets because that is not what the trust intends his role to be. Whether he actually receives distributions or not, the beneficiary knows he can access the assets at will. This knowledge allows him, in Justice Kagan's words, to "make the different life choice"—such as building his dream house at forty without having saved money out of his earnings to do so.

In *Pfannenstiehl*, the beneficiary of a trust, named Curt, had been married for twelve years to Diane when he filed for divorce.[93] Curt belonged to a wealthy family and received distributions from the family trust totaling $800,000 in the two years before the divorce, as did his two siblings.[94] The trial court found that the trustees, Curt's brother and the family attorney, stopped sending Curt checks on the eve of the divorce "because [they] deemed it too risky to distribute funds to Curt at a time when he might be required to share the funds with Diane, a nonbeneficiary."[95] During this time, however, the trustees continued to make distributions in similar amounts to Curt's two siblings.[96]

The trial judge agreed with Diane that Curt's share in the trust should be part of the marital estate, subject to division.[97] She based this on her findings that the trust had "augmented" the couple's lifestyle throughout the marriage.[98] The judge noted that the trust was worth $25 million, and that the

92. I want to thank Professor Kent Schenkel for creating this very apt variation of the facts.
93. Pfannenstiehl v. Pfannenstiehl, 55 N.E.3d 933, 935 (Mass. 2016).
94. *Id.* at 937.
95. *Id.*
96. *Id.*
97. *Id.* at 937–38.
98. *Id.*

trustees had already distributed nearly one million to Curt alone, only stopping because they wanted to make sure Diane did not receive any of the assets.[99] The appeals court termed this maneuver "a deliberate manipulation to erase a major component of the husband's annual income and to silence his interest in the trust—for a convenient time while the divorce was ongoing."[100]

The SJC reversed this part of the holding based on the technical language of the trust instrument rather than the reality of the situation.[101] It cited language which gave the trustees "sole discretion" in making distributions.[102] It ignored the rest of the language in the same paragraph which limited the trustees' discretion to the standard of "comfortable support, health, maintenance, welfare and education."[103] It also noted that the class of beneficiaries, consisting of the father's "issue," was open.[104] The court ignored the reality that one of the trustees was Curt's brother. Neither trustee seemed to have any qualms about distributing nearly one twentieth of the trust to him over the course of a mere two years, distributions the appeals court found to be "woven into the marriage fabric,"[105] and continued to make similar distributions to his two siblings after Curt's distributions stopped. Again, title split and technical language blinded the court to the reality of the beneficiary's access to the funds in a family trust.

Finally, the Kaestner trust's spendthrift clause gave Kaestner significant property power had she ever needed it.[106] Common in trusts, the spendthrift clause bars both voluntary and involuntary assignment of trust assets. In other words, it prevents any creditor from reaching the trust's assets to satisfy a debt, and it bars the beneficiary from using trust assets to secure a debt. Often such a clause is used to prevent a tort creditor from collecting from the tortfeasor's assets.[107] If Kaestner had committed a tort in North Carolina, the victim would not have been able to reach her trust assets to pay any judgment against her. If she had no other assets, this would have left the tort victim high and dry, and the state's tax payers on the hook. For example, if she had

99. Pfannenstiehl v. Pfannenstiehl, 37 N.E.3d 15, 19, 21 (Mass. App. Ct. 2015).
100. *Id.* at 23.
101. Pfannenstiehl, 55 N.E.3d at 935.
102. *Id.* at 938.
103. *Id.*
104. Pfannenstiehl, 55 N.E.3d at 936.
105. Pfannenstiehl, 37 N.E.3d at 25.
106. Joint Appendix, *supra* note 15, at 70–71 (Trust Instrument, Art. 12).
107. Schenkel, *supra* note 43, at 133.

severely injured someone, say, in a drunk driving accident,[108] and had no other assets, the trust's spendthrift clause would make her judgment proof and force the state to pay for the plaintiff's care. If she had defaulted on an unsecured debt to a North Carolina bank, and, again, had no other resources, the bank would not have had access to her trust assets, and her default would have had the effect of increasing interest rates for the rest of the state's citizens. If she had failed to pay court ordered alimony in North Carolina, neither the ex-spouse nor the state would have had any recourse, likely creating a burden on the other taxpayers in the state.

Counsel for the respondent points to the trust's spendthrift clause as proof that Kaestner lacked power over the trust assets because it denied her the right to sell or alienate the trust assets.[109] This is the traditional view of spendthrift clauses, but it is quite misleading—in fact, the opposite is true. As Professor Schenkel points out, the effect of these clauses simply imposes externalities on everyone who is not inside the trust relationship.[110] In fact, they increase the beneficiary's property power, relieving her of normal costs of many of her actions.

Conclusion

The logic of property power does not apply to all forms of trusts and all classes of beneficiary. This case deals with a discretionary family trust with a closed class of beneficiaries, limited by an ascertainable standard and other language in the trust expressing the intent of the grantor. Moreover, the facts of the case clearly show that the beneficiary had access to the income had she chosen it. In such a case, the state has jurisdiction to tax the beneficiary even if her share of income remains undistributed. Such taxation does nothing more than acknowledge the reality the trust's title split tries to hide. Once we see through this sleight of hand, it becomes clear that Kaestner benefitted from the trust income in ways that subject her to state taxation.

This might not always be the case. For example, there might a beneficiary whose interest is truly contingent on a condition precedent, such as the death of a current beneficiary, without which it will not vest. Or, the trust might direct the trustee to limit the distributions to a certain amount or frequency, or to medical emergencies. It is also true the trusts set up for

108. This is purely a hypothetical; there is no evidence whatsoever that Ms. Kaestner would ever be likely to do such a thing.
109. Transcript, *supra* note 23, at 55–56.
110. Schenkel, *supra* note 43, at 73–87.

business purposes are quite different and raise different tax issues. But now is the time for courts to recognize the property power many discretionary trusts confer on their beneficiaries and stop following the red herring of the trust.

Crawford and Simon admit that current state trust taxation allows "any particular trust [to] avoid taxation entirely."[111] This understates the problem. One point four million trusts that accumulated income (trusts like the Kaestner Trust) filed tax returns in 2014 (the most recent year with compiled data).[112] These trusts collectively reported ninety billion dollars in income.[113] This puts at stake a huge amount of taxes dollars. A ruling for Kaestner in this case would allow significant tax avoidance on assets of this magnitude, and encourage many more high net worth people to transfer more assets to this type of trust.[114]

Vertical equity is an underlying principle of tax law. It means that the higher up the income ladder you go, the higher your ability to pay taxes, and the more you should pay. The rich should pay their fair share of taxes based on their wealth. The extensive tax shelters that trusts provide create asymmetric and unequal contributions to the public fisc by taxpayers, and certainly do not calibrate contributions based on ability to pay.

Crawford and Simon's solution seems less workable than simply allowing a state to tax a resident beneficiary. They suggest that states that do tax distributed trust income tax not only the tax year's distributed income, but also distributions that are "attributable to previously accumulated income."[115] This scheme, however, seems much more complicated than simply recognizing that beneficiaries of discretionary family trusts should pay taxes on trust income, whether technically distributed or not. Apart from anything else, their proposal would require states to pass complicated new laws, and likely encourage beneficiaries to postpone distributions until they could move to states with no income tax. They might do this after raising families, attending schools, and enjoying state services for years in a state which would be unable to tax their trust income to pay for those services. This case is a rare opportunity for the Court to address the tax inequity that allows the wealthy

111. Crawford & Simon, *supra* note 2, at 17.
112. *Fiduciary Income Tax Returns, Income Source, Deductions, and Tax Liability, by Type of Entity, Filing Year 2014*, INTERNAL REVENUE SERV. (Oct. 2015), https://www.irs.gov/pub /irs-soi/14fd02.xlsx.
113. *Id.*
114. *See* Brief of Tax Law Professors as Amici Curiae in Support of Petitioner, N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 915 (2019) (No. 18-457).
115. Crawford & Simon, *supra* note 2, at 17.

to accumulate assets tax free and in so doing, force those with less to make up the difference and deplete the public fisc. It offers a rare opportunity for the Court to see through the trust's sleight of hand.

This case calls for attention to the reality of family trusts and their role in maintaining what Allison Tait has called "the law of high wealth exceptionalism."[116] This refers to a legal regime which allows high net worth families to live in legal and political worlds of their own, insulated from the society around them, including its laws and the obligations which attach to property for most families. Family trusts like the Kaestner trust play a central role in layering this insulation. Referring to family trust companies, Tait observes that that one of their basic purposes is to obscure ownership of assets. She notes that they serve to "provide a firewall between an asset and its owner," creating optimal conditions for "tax avoidance and evasion."[117] Family trusts play a similar and related role, as the confusion about ownership in this case's record shows. Indeed, the trust is uniquely suited to create exactly this kind of mystification—fulfilling its original purpose.[118]

A basic principle of tax law is the "substance over form" doctrine, which looks at the economic reality of a transaction rather than its form to assess whether there has been tax evasion. [119] To find the substance of a transaction, courts have always been ready to take family relationships into account. Indeed, transactions that take place among family members and create tax benefits are to be carefully scrutinized "in order to determine if they are in economic reality what they appear to be on their face."[120] The critical fact determination of the Court is whether there was an understanding between the donor and the donee that one of them would act in a certain way. Here, the record makes clear that Kimberley Kaestner understood she had access to the assets in the trust if she wanted them, for charitable or other purposes. Joseph Lee Rice III created the trust to pass on family wealth to his children, and when Kimberley reached an appropriate age, the trustee sat her down and introduced her to its details. From then on, she was involved in trust management, to the extent of complaining about the trust's large legal expenses.

116. Allison Anna Tait, *The Law of High-Wealth Exceptionalism*, ALA. L. REV. (forthcoming 2019).

117. *Id.*

118. *See* SIMPSON, *supra* note 32, at 174–75.

119. Christina R. Edson, *Quill's Constitutional Jurisprudence and Tax Nexus Standards in an Age of Electronic Commerce,* 49 TAX L. 893, 943 (1996).

120. Gibbon v. Commissioner, 19 T.C. 78, 84 (1952).

The trust's unique device of separating legal from equitable title can serve many legitimate purposes. Trusts can protect minors and the vulnerable. They can also serve as perfect vehicles for many types of businesses and investments. However, their ability to separate beneficial enjoyment of property from the legal obligations normally attached to property ownership hides dangerous—and undemocratic—possibilities. When wealthy families use trusts to avoid paying their fair share of taxes, they cease to act as economic citizens, in effect removing themselves from the democratic political order which the rest of us inhabit, and creating their own sovereign states, with, but not among, us. Attention to the reality of such trusts can stop this.