



February 20, 2019

Important Notice: United States Supreme Court Agrees to Hear North Carolina Trust Income Taxation Case

On January 11, 2019, the U.S. Supreme Court granted the State’s petition for a writ of certiorari in the matter of *Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue*.¹ In October 2018, the North Carolina Department of Revenue (“Department”) filed a petition for certiorari in the U.S. Supreme Court, asking whether North Carolina may, consistent with the federal due process clause, impose a tax on the income of a trust based, in part, on the in-state residency of a beneficiary.

Background

North Carolina trust income tax law permits the State to tax the undistributed income a trust earns for the benefit of a State resident, or for the benefit of a nonresident to the extent the income is derived from North Carolina sources. The Kimberly Rice Kaestner 1992 Family Trust (“Kaestner Trust” or “Trust”) challenged the law by filing a request for refund, claiming the tax is unconstitutional because the Trust lacked sufficient minimum contacts with North Carolina.

On April 23, 2015, the North Carolina Business Court found that, where the only basis for the imposition of the tax was the residence of the beneficiary, taxation of trust income was unconstitutional.² Both the North Carolina Court of Appeals and the North Carolina Supreme Court affirmed the Business Court’s decision.³ The Department’s petition for certiorari with the U.S. Supreme Court asks whether the federal due process clause prohibits a state from taxing trusts based on trust beneficiaries’ in-state residency.

¹ *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, U.S. Supreme Court, Dkt. 18-457, petition for certiorari granted January 11, 2019.

² *Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue*, 2015 NCBC 36.

³ *Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue*, 789 S.E.2d 645 (N.C. Ct. App. 2016), and *Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue*, 814 S.E.2d 43 (N.C. 2018), respectively.

North Carolina Tax Statutes

A taxpayer may request a refund of an overpayment made by the taxpayer by taking one of the following actions within the statute of limitations for obtaining a refund: (1) filing an amended return reflecting an overpayment due the taxpayer, or (2) filing a claim for refund. N.C. Gen. Stat. § 105-241.7(b). Subsection (a) of N.C. Gen. Stat. § 105-241.6 provides the general statute of limitations period, which is the later of: (1) three years after the due date of the return, or (2) two years after payment of the tax.

N.C. Gen. Stat. § 105-241.6(b) provides exceptions to the general statute of limitations for obtaining a refund of an overpayment. Subdivision (5) of subsection (b) provides an exception due to a “contingent event.” N.C. Gen. Stat. § 105-241.6(b)(5)a defines a contingent event to mean “litigation or a state tax audit initiated prior to the expiration of the statute of limitations” which prevents a taxpayer from possessing the information necessary to file an accurate and definite request for refund of an overpayment.

According to State law, a person subject to a contingent event must file a written notice with the Secretary of Revenue prior to the expiration of the general statute of limitations for obtaining a refund. N.C. Gen. Stat. § 105-241.6(b)(5)a. The notice must identify and describe the contingent event, identify the type of tax affected by the contingent event, list the return or payment affected by the contingent event, and state in clear terms the basis used to determine the estimated amount of the overpayment. *Id.* If a taxpayer is subject to a contingent event and properly files written notice with the Secretary, the period to request a refund of an overpayment is six months after the contingent event concludes. *Id.* A taxpayer is not permitted to request a refund of an overpayment based on a contingent event as defined in G.S. 105-241.6(b)(5) until the event is finalized and an accurate and definite request for refund of an overpayment may be determined. N.C. Gen. Stat. § 105-241.7(b).

Application of North Carolina Tax Statutes

As stated earlier, on January 11, 2019, the United States Supreme Court agreed to review the North Carolina Supreme Court’s decision regarding the Kaestner Trust. Because the case is currently before the United States Supreme Court, the contingent event regarding the facts of the Kaestner Trust (the “Kaestner Contingent Event”) has not concluded.

A fiduciary of a trust who believes the facts of Kaestner apply to the facts of the trust should file [Form NC-14](#), Notice of Contingent Event or Request to Extend Statute of Limitations, prior to the expiration of the general statute of limitations for obtaining a refund for any year the Kaestner Contingent Event prevents the trust from filing a definite request for refund with the Department. Affected persons should refer to the

Department's Directives, [TA-16-1](#) and [TA-18-1](#), for guidance as to when a mailed document is considered timely filed.

Importantly, pursuant to N.C. Gen. Stat. § 105-241.7(b), an amended return or claim for refund filed after the June 8, 2018, North Carolina Supreme Court decision (a "Refund Claim") by a person that timely filed a written notice of contingent event with the Secretary (an "Affected Taxpayer") is premature and cannot be processed. The Department will notify the Affected Taxpayer by letter and will return the Refund Claim as premature. The Department will not keep a record of the Refund Claim returned to the Affected Taxpayer. An Affected Taxpayer should file an amended return or claim for refund to request a refund of an overpayment within six months after the Kaestner Contingent Event concludes in order for the amended return or claim for refund to be considered timely filed.

Assistance

If you have any questions about this notice, you may call the Contact Center at 877-252-3052 (8:00 am until 5:00 pm EST, Monday through Friday), or write the Department at PO Box 1168, Raleigh, NC 27602.

To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this Important Notice, the provisions in this Important Notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance regarding the subject of this Important Notice and issued prior to this Important Notice conflict with this Important Notice, the provisions contained in this Important Notice supersede the previous guidance.