Alert: Minnesota Supreme Court Case May Change Taxation of Minnesota Trusts

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On July 18, 2018, the Minnesota Supreme Court issued its highly anticipated decision in the case of *Fielding v. Commissioner of Revenue*, 2018 WL 3447690, determining that Minnesota's attempt to tax trust income based solely on the grantor's residence at the time the trust becomes irrevocable is unconstitutional.

In 2009, Reid MacDonald established four separate trusts for his children and transferred shares of a Minnesota S corporation to each trust. On December 31, 2001, the trusts became irrevocable, and, based on the fact that Reid was a Minnesota resident at this time, the trusts were deemed "Resident Trusts" under Minnesota law. As a result of their classification as Resident Trusts, nearly all the income earned by the trusts was subject to Minnesota income tax.

In 2014, the trusts sold their shares of the Minnesota S corporation and deposited the sale proceeds in investment accounts owned by the trusts. Because the trusts were Resident Trusts according to Minnesota law, they were subject to Minnesota income tax on the sale of the S corporation stock and on all the income generated by other investments owned by the trusts.

The trusts filed their 2014 Minnesota income tax returns under protest, asserting that the statute classifying them as Resident Trusts was unconstitutional. The trusts then filed amended tax returns and claimed refunds for the difference between the taxes owed as Resident Trusts and the taxes owed as nonresident trusts — a tax savings of more than $250,000 for each trust. The trusts argued that they lacked sufficient contact with Minnesota to be taxed as Minnesota Resident Trusts noting that when the stock was sold, the trustee who oversaw the administration of the trusts resided in Texas and maintained the trust records in Texas, the investment accounts were administered in California, and three of the four beneficiaries resided in states other than Minnesota.

The Supreme Court ultimately determined the grantor's status as a Minnesota resident when a trust became irrevocable – without more factual basis – was insufficient to indefinitely subject the trust to Minnesota income tax. Absent additional relevant contacts to Minnesota, such as ownership of tangible property located in Minnesota, trustee contact with the state, and trust administration activities conducted in Minnesota, the law characterizing the trusts as Resident Trusts is inconsistent with the Due Process Clause of the United States Constitution.

In light of the *Fielding* decision, any trust that became irrevocable when the grantor was a Minnesota resident should be reviewed to determine whether the trust is properly classified as a Minnesota Resident Trust.

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