



Illinois Appeals Court Holds Taxation of Trust Established By Illinois Grantor Unconstitutional

by Eric C. Nelson and Edward A. Trio

In a recent decision, *Linn v. Department of Revenue*, the Illinois Fourth District Appellate Court held that Illinois taxation of a trust owing its existence to a trust established by an Illinois grantor with no current connection to Illinois was unconstitutional.

An Illinois resident trust is subject to Illinois tax (5% income tax plus 1.5% personal property replacement tax) on all of its income. A resident trust for Illinois purposes is:

- (1) a trust created by a will of a decedent who at his death was domiciled in Illinois; and
- (2) an irrevocable trust, the grantor of which was domiciled in Illinois at the time such trust became irrevocable. Grantor trusts are not treated as irrevocable for this purpose.

The trust in question in *Linn*, Autonomy Trust 3, originated from the 1961 creation by A.N. Pritzker of separate irrevocable trusts for family members (the “P.G. Trusts”). Pritzker and the trustee of the P.G. Trusts, Meyer Goldman, were Illinois residents at the time the trusts were created. One of the trusts created was for the benefit of A.N.’s granddaughter, Linda Pritzker, and was named the “Linda Trust.” In 2002, the trustees of the Linda trust exercised a power of appointment they held over the Linda Trust in favor of Autonomy Trust 3. By 2006, Autonomy Trust 3’s beneficiary, trustee and trust protector were all not residents of Illinois. In addition, none of the trust’s assets were located in Illinois. The Autonomy Trust 3 governing document provided that the Autonomy Trust 3 was to be construed and regulated by Texas law.¹

In ruling that the Illinois taxation of Autonomy Trust 3 was unconstitutional, the court applied the standard set forth in *Quill Corp. v. North Dakota*, a 1992 U.S. Supreme Court case, which provides that in order for state taxation to not be an unconstitutional violation of due process, “(1) a minimum connection must exist between the state and the person, property, or transaction it seeks to tax, and (2) the income attributed to the State for tax purposes must be rationally related to the values connected with the taxing state.”

In *Linn*, the court held that the Illinois taxation of Autonomy Trust 3 violated due process because:

1. No non-contingent trust beneficiary resided in Illinois;
2. No Illinois probate court had jurisdiction over the trust;
3. The choice of law provision contained in the trust provided for the application of only Texas law;

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4. Neither the trustee nor trust protector resided in Illinois; and
5. The trust held no Illinois assets and all of its business was conducted in Texas.

Filing In Illinois Following Linn

Following *Linn*, trustees that have been paying tax in Illinois may want to review their trust's connections with Illinois to determine whether the trust can file as a non-resident in the future or should amend prior returns and request a refund. While it is possible the ruling in *Linn* could be overturned if the Illinois Department of Revenue appeals the decision, for now the *Linn* decision can be relied upon to avoid Illinois tax penalties if a trust with similar characteristics files as a non-resident.

Also, trustees that have been filing in Illinois should consider whether their trusts can be modified by the exercise of a power of appointment or by use of the Illinois decanting statute to effectively sever the trust's ties to Illinois.

¹ When initially created Autonomy Trust 3 contained language that certain terms were to be interpreted under Illinois law. These provisions of the trust were stricken pursuant to a Harris County, Texas 2005 court reformation of the trust.

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