1. Introduction

a. Increasing estate/gift exemptions removes many estate and gifts from tax, but the 10-year enforcement period means that a gift in 2006 can be enforced in 2016, or an decedent’s estate tax in 2006 can continue until 2016.

b. The subject of collecting estate and gift taxes is interesting and complex for a variety of reasons:

i. The receipt of a gift of money or property is usually accompanied by the emotion of thanks or gratitude, but the hidden subject of potential donee liability is not often mentioned, but the risk is real. Does the donee wonder whether the donor is satisfying his or her tax obligations on filing a gift tax return and paying the concomitant tax, not only for the gift involving the specific donee, but all donees for all gifts for the calendar year? Does the donee appreciate that potential gift tax liability can exist for a decade following the gift at least and perhaps much, much longer?

ii. Does a purchaser of property from or secured lender to a donee question the source of the property and wonder whether there is a tax lien attached to the subject property, a question made all the more challenging in light of the absence of a filed tax lien for delinquent gift taxes?

iii. Does a spouse who agrees to the rather routine split gift appreciate the several nature of potential gift tax liability should the gifting spouse fail to file a gift tax return or pay the resulting gift tax?

iv. Does an executor know of all transactions involving decedent and family members or the donees that might generate gift tax?

1 Partner, Elliott, Thomason & Gibson, LLP, Dallas, Texas. A more extended analysis of the issues raised in this paper can be found at W. Elliott, FEDERAL TAX COLLECTIONS, LIENS & LEVIES (Warren Gorham & Lamont, 2016, 2nd ed.).
v. Are estate beneficiaries aware of potential personal liability that they might possess if the executor fails to file an estate tax return or pay the requisite estate tax?

vi. Are executors certain that decedent’s prior income tax are adequate and estate taxes have been paid when making estate distributions?

c. The IRS possesses some dozen or so tax collection strategies to collect delinquent estate and gift taxes. In contrast to tax advisors who advise clients in real time, the IRS usually has the benefit of hindsight in determining which of the array of strategies it wishes to employ.

d. The array of tools available to the Service to collect delinquent estate and gift taxes involves traditional tax collection remedies, including tax liens and levies, which can be asserted against the transferor estate fiduciary or the donor, and supplemental or specialized remedies uniquely suited to estates or gift transactions.

i. Section 6901 provides a traditional method of collecting transferee tax liability using state law or Federal Debt Collection Procedures Act as the substantive law.²

ii. Supplemental statutory remedies are provided the Service to enable the Service to follow estate or gift assets into the hands of the estate beneficiaries or transferees or donees, or even transferees of transferees.

iii. Added punch is provided the Service to assert personal liability on estate fiduciaries or transferees of estate assets or donees of gifts.

2. Tax Collection for Delinquent Estate or Gift Taxes

a. Assessed in Same Manner. Federal estate and gift taxes are usually assessed in the same manner as other federal taxes, against the decedent’s estate or the donor of the gift.

² Transferee liability, generally, is discussed in William D. Elliott, Federal Tax Collection, Liens & Levies (Warren Gorham & Lamont, 2015), Chapter 18.
i. For delinquent estate taxes, the executor of the estate is the person against whom the tax is assessed and from whom payment is normally expected.

   1. The usual process of notice, assessment and collection would be followed against the executor.

   2. The general tax lien rules of IRC §6321 would be used.

ii. For delinquent gift taxes, the donor of the gift is the person against whom a deficiency is determined. IRC collection is against the donor.

iii. If tax assessment is not paid, then a general tax lien arises against property of the taxpayer, which is the estate in the case of estate taxes and the donor in the case of gift taxes.

iv. Third party liability is usually secondary in these situations.

b. Supplement Remedies. Supplementing these general rules are a variety of remedies are available to the IRS against donees, executors, heirs, legatees, and other persons, along with liens attaching to property included in taxable gifts or taxable estates.

   i. Create personal liability against certain third persons, and

   ii. Create a special tax lien on property transferred by the decedent or the donor.

   iii. Third party liability can be a direct liability, and not secondary. Transferees or donees can be liable for the entire unpaid estate or gift tax amount, but limited by the amount of their share of the estate or the gift they received.

c. Is Estate a Transferee? Although not normally encountered, nevertheless, the death of a person who was a potential transferee means that the decedent’s estate can be a transferee itself for any federal tax owed by decedent including income or gift taxes.

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3 IRC §§2501, 2502(c). The donor has the primary responsibility for paying the gift tax, and all penalties and interest on the gift tax.
EXAMPLE: Decedent had been shareholder of corporation. Shortly after death of the decedent, the corporation was liquidated and the estate received assets in liquidation. The estate is liable as transferee for unpaid income taxes of corporation.4

3. Collection of Delinquent Gift Taxes

a. General. The IRS strategies involve two major parts:

i. Traditional tax collection against donor, which involve similar to strategies to collect a delinquent income tax, which are:

1. Filing a general tax lien on the donor’s assets, and
2. Levying and seizing on donor’s property and rights to property, and
3. Foreclosing on the tax lien against donor.

ii. Supplemental remedies provided in IRC §6423(b) to collect a delinquent gift tax, which involve:

1. Gift tax lien on gifted property
2. Personal liability imposed on donees (or other third parties)

b. Donor is Primarily Responsible. The donor is primarily responsible for gift taxes, including penalties and interest.5

i. If donor dies before paying gift taxes, then donor’s estate and donor’s executor or administrator becomes responsible for payment of the gift tax

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4 Example based on Estate of Smith v. Comm’r, 16 TC 807 (1951); Estate of Harrison v. Comm’r, 16 TC 727 (1951). Both cases appear to have arisen from the same underlying facts.

5 IRC §§2501. 2502(c).
debt. The fiduciaries of donor’s estate bear personal liability risk for failing to pay the gift tax debt.

ii. If there is no duly qualified executor or administrator, then those taking from the estate (heirs, legatees, devisees, and distributees) become liable for the gift tax debt.

iii. A split gift by husband and wife may enable collection against the spouse since the liability with respect to the gift tax for each spouse for that calendar year is joint and several.

c. Limitations to Collection Gift Tax. The collection statute of limitations for collecting the gift tax is 10 years from assessment date of the gift tax, plus extensions provided by law.

4. Break Down of Statutory Language of IRC §6324(b)

a. Section 6324(b) imposes the donee personal liability and uses few words to do it. To understand the statutory structure, the entire IRC §6324(b) text should be considered, but adding outline features along with subdivisions and cross references and captions to ease understanding:

IRC §6324(b):

(b) Lien for gift tax

[1] [Creation of Lien] Except as otherwise provided in subsection (c) concerning mechanics liens per IRC §6323(b) and interest and expenses for a loan per IRC §6323(e), unless the gift tax imposed by chapter 12 [gift tax statutes IRC §§2501-2524] is sooner paid in full or becomes unenforceable by reason of lapse of time,

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7 31 U.S.C. §3713(a). This subject discussed later in outline.


9 IRC §6502.
[A] such [gift] tax shall be a lien upon all gifts made during the period for which the return was filed,

[B] for 10 years from the date the gifts are made.

[2] **Imposition of Transferee Liability** If the [gift] tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.

[3] **Transfer of Gifted Property by Donee** Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee)

[A] to a purchaser or

[B] holder of a security interest

[4] **Divestment of Lien** shall be divested of the lien imposed by this subsection and

[5] **Attachment to Donee’s Property** such lien,

[A] [Limitation] to the extent of the value of such gift,

[B] **To all of Donee’s Property** shall attach to

[1] all the property (including after-acquired property) of the donee (or the transferee)

[2] **Exception for Transfers or Loans** except any part transferred to a purchaser or holder of a security interest.\(^\text{10}\)

b. **Misleading Caption.** The caption for IRC §6324(b) is misleading for there is more in the provision than creation of a tax lien.

i. **Lien.** The first sentence creates a lien for delinquent gift taxes on all gifts made during the period for which a gift tax return is filed. The lien is to last for 10 years from when the gift is made.

\(^{10}\) IRC §6324(b).
ii. **Transferee Liability.** The second sentence of IRC §6324(b) provides for transferee liability on the donee of the gift to the extent of the value of the gift. The key statutory language creating personal transferee liability is:

*If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.*

iii. **Divestment of Lien.** The third sentence exception (1) If a donee transfers property to a purchaser or holder of a security interest, then (2) the gift tax lien is divested from the property so conveyed or pledged, and (3) to the extent of the value of the gift, attaches to all remaining property of the donee, (4) except that part transferred to a purchaser or holder of a security interest.

5. **Tax Liens Applicable in Gift Tax Situations**

   a. **General Tax Lien.** The general lien of IRC §6321, which attached to the donor's assets upon failure to pay the gift tax, may be used to collect the gift tax account.

   i. A general tax lien arises and attaches to all of the property and rights to property of the donor as of the date of assessment, but because the property given as a gift was transferred out of the donor's hands before there was an assessment, the gifted property is not subject to this lien unless re-acquired by the donor.

   ii. This general tax lien arises on the date of assessment, and expires when the IRC §6502 limitations period expires.

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12 IRC §6324(b).

13 IRM 5.5.7.26 (Sept. 16, 2013); IRM 5.5.9.9 ((Sept. 16, 2013).

14 IRM 5.5.9.9 ((Sept. 16, 2013).
iii. The tax lien is not limited to 10 years from the date of the gift.

iv. Requires notice and demand be given to the donor.

v. The general tax lien does require filing of a Notice of Federal Tax Lien to defeat certain creditors.

vi. May be enforced by levy or seizure against the donor's other property and rights to property.

vii. May be enforced through judicial suit to foreclose the lien when necessary.

b. **Special Gift Tax Lien.** A special gift tax lien arising under IRC §6324(b) also arises against the gifted property. It applies to all gifts made during the period for which the unpaid gift tax arose, and includes gifts made to all donees even if they were subject to the annual exclusion or other deductions. The gift tax lien attaches to appreciation on the gifted property, and is not limited to the value of the gift on the date of the donation.\(^\text{15}\)

   i. This lien follows the gift into the donee's (or transferee of a donee) hands and into subsequent transferee's hands unless they are purchasers or security interest holders.

   ii. If donee or a subsequent transferee of the donee re-transfers the gift to a purchaser or security interest holder, the gift is divested of the gift tax lien and a replacement gift tax lien arises on all of the donee's other property and after-acquired property.

   iii. No assessment is necessary

   iv. Notice and demand are not required

   v. No public filing of the lien is required

\(^{15}\) IRC §6324(b); IRM 5.5.9.9 ((Sept. 16, 2013).
vi. Both the gift tax lien and the replacement gift tax lien expire 10 years after the date of the gift and cannot be extended.

vii. Can be enforced through seizures and levies so long as the 10 years has not expired.

c. **Both Tax Liens Can Be Enforced.** Both the general tax lien and the gift tax lien can be used to collect a gift tax liability. Enforcement of either or both liens are possible. The IRS is not required to pursue donor first.

6. **Personal Liability for Gift Taxes.**

a. **Donee Personal Liability.** Apart from the tax collection tools that can be employed against the donor, the IRS has a powerful supplemental weapon to collect delinquent gift taxes by asserting personal liability on donees. Donees of gifts bear the risk of personal liability for unpaid gift taxes on the gift.

b. **Personal Liability on Donee.** The transferee liability on donees is personal liability up the value of the gift for the entire amount of the gift tax for the year of the gift.

   i. Donee’s liability arises at the moment the donor fails to pay the gift tax.\(^{16}\)

   ii. It is of no matter that the gift tax marital deduction or charitable deduction was allowed for the gift to the donee, or the gift was within the gift tax annual exclusion.\(^{17}\)

   EXAMPLE: Donor makes gift under the annual exclusion to daughter and another gift also under the annual exclusion to son and third gift in trust for the benefit of minor child. The gift in trust is treated as a gift of a future interest and the gift exclusion disallowed. IRS notifies daughter and son of gift tax

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\(^{16}\) See Poinier v. Comm’r, 858 F.2d 917, 920 (3d Cir.1988) (“Since a gift tax was due and unpaid, the donees are liable for its payment”); Mississippi Valley Trust Co. v. Comm’r, 147 F.2d 186, 187-188 (8th Cir. 1945) (“If the donor fails to pay the automatically imposed tax when due, in accordance with the statute, no matter what the reason for his failure, there is an immediate and direct liability on the donee for the legally-owed tax, to the extent of the value of the gift.”).

\(^{17}\) Baur v. Comm’r, 145 F.2d 338,339-40 (3rd Cir. 1944).
deficiency on account of the disallowance of the annual exclusion of the gift in trust. Any donee for the year is potentially liable for donor’s gift tax deficiency even though it was not the gift to the daughter or son that gave rise to the gift tax in question.  

iii. Solvency of donor is immaterial. The Third Circuit made this point succinctly:

[I]t is wholly immaterial to the enforcement of the legal liability whether the transfers rendered the donor insolvent or whether he remained solvent during the period of his enforceable liability for the tax.  

iv. The singular condition of transferee liability is that the donor failed to pay the gift tax when due.  

1. No showing need be made that the Service attempted to collect the gift tax from the donor. 

2. Reference to the donor liability being primary and donees being secondarily liable are imprecise, as stated by the Tenth Circuit:

Indeed, once the donor fails to pay the underlying gift tax, the IRS may elect to collect the tax from either the donor or the donee, and need not take any

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18 Example taken from Baur v. Comm’r, 145 F.2d 338,339 (3rd Cir. 1944)(“The words of the provision above quoted are so plain as not to leave any room for doubt that it was the congressional intent, thereby to render a donee personally liable (to the extent of the value of his gift) for the gift tax due by the donor regardless of the fact that the gift to the particular donee did not contribute to the imposition of any tax.”).


20 United States v. Botefuhr, 309 F.3d 1263, 1276 (10th Cir. 2007). See IRC § 2502(c) (“The tax imposed by §2501 shall be paid by the donor.”); Fletcher Trust Co. v. Comm’r, 141 F.2d 36, 39 (7th Cir. 1944)(“The provisions of the Act ... make plain ... that the liability of the donor is primary....”).

21 La Fortune v. Comm’r, 263 F2d 186 (10th Cir. 1958), and cases there cited.
direct action against the donor before pursuing the donee.  

v. Courts interpreting IRC §6324(b) routinely analyze the personal liability component of IRC §6324(b) as being independent from and without reference to the lien provision.

c. Extent and Limit on Amount of Donee’s Liability

i. The value of the gift is the maximum extent of donee’s liability for both the gift tax and interest. All interest is covered by this ceiling, including interest after a notice of transferee liability is issued.

ii. The statement of limitation of donee’s liability creates a false comfort because a donee is liable for the entire amount of unpaid gift taxes for gifts made by donor for the calendar year, and not just the gift taxes attributable to the particular donee.

1. IRC §6324 imposes liability on a donee “for any gift tax incurred by the donor during the year in which the donee received a gift, regardless of whether that individual donee’s gift actually contributed to the donor's gift tax deficiency.”

2. Thus, a donee’s liability may be more extensive than first appears.

d. Means of Enforcing Donee Liability

i. A claim for personal liability of a donee under IRC §6324(b) may be brought by the Service as a direct action against the donee without any

22 United States v. Botefuhr, 309 F.3d 1263, 1276 (10th Cir. 2007).

23 United States v. Botefuhr, 309 F.3d 1263, 1276 (10th Cir. 2007), citing La Fortune v. Comm’r, 263 F2d 186 (10th Cir. 1958); Baur v. Comm’r, 145 F.2d 338, 340 (3rd Cir. 1944); see also, most recently, Tilton v. Comm’r, 88 T.C. 590, 594 (2015) (“It will be observed that this language [the language of IRC § 6324(b)] imposes a lien upon any gift to secure payment of the tax and, if the tax is not paid when due, personal liability on the donee to the extent of the value of such gift.” (internal quotation marks deleted)).

24 United States v. Botefuhr, 309 F.3d 1263, 1276 (10th Cir. 2007); Want v. Comm’r, 280 F.2d 777, 781 (2d Cir.1960); La Fortune v. Comm’r, 263 F.2d 186, 194 (10th Cir.1958)).
prior assessment against the donee under IRC §6901.\textsuperscript{25}

ii. The IRS could enforce donee liability through an assessment under IRC §6901(a)(1)(A)(iii), which permits any person’s liability as a transferee of property to be assessed and collected in the same manner as a tax imposed directly on the transferee.\textsuperscript{26}

1. The transferee/donee would be subject to the usual procedures for collection of a tax, namely, statutory notice of deficiency under IRC §6212, following assessment, creation of, together with attachment of, a federal tax lien against the transferee/donee’s property and rights to property under IRC §6321, collection by levy and seizure or suit to foreclose the tax lien.

2. Asserting transferee liability against a donee under IRC §6901 provides an additional one-year period under the statute of limitations.

3. Burden of proof in the Tax Court is altered requiring the Service to prove that the transferee/donee is liable as a transferee.\textsuperscript{27}

\textsuperscript{25} Numerous authorities have reached this holding: See United States v. Geniviva, 16 F.3d 522, 524 (3d Cir.1994) (explaining that IRC § 6324 predates IRC § 6901, which, rather than eliminating the remedy provided by IRC § 6324, merely provides an additional method of tax collection); United States v. Russell, 461 F.2d 605 (10th Cir.1972) (holding that “the collection procedures of [IRC] § 6901 are cumulative and alternative—not exclusive or mandatory”); United States v. Estate of Davenport, 159 F.Supp.2d 1330, 1335 (N.D.Oka.2001), rev'd in part on other grounds, United States v. Botefuhr, 309 F.3d 1263 (10th Cir.2002). While Geniviva and Russell arose out of the government's attempt to collect delinquent estate taxes from transferees under IRC § 6324(a), it is well-established that the gift tax and estate tax provisions of IRC § 6324 “are in pari materia and must be construed together.” Estate of Sanford v. Comm’r, 308 U.S. 39, 44 (1939), cited in Botefuhr, 309 F.3d at 1276 n. 9.

\textsuperscript{26} IRC §6901(a)(1)(A)(ii).

\textsuperscript{27} M. McMahon & Zelenak, Federal Income Taxation of Individuals (Thompson Reuters 2016, 3d ed.) ¶48.07[1] n.68; see also IRM 35.2.2.7.1 (Sept. 24, 2012).
e. Transferee of Donee

i. If the donee transfers the gifted property, then the Service can use IRC §6901 procedures to assess and collect taxes, penalties and interest owed by the transferor against a transferee of a transferee/donee.28

ii. For transferees of transferees, an additional period of one year is provided after expiration of the limitations of the original transferee/donee.29

f. Statute of Limitations on Suit to Enforce Donee Liability

i. Claims against a transferee under IRC §6324(b) must be brought within the period prescribed by IRC §§6501 and 6502.30 Section 6501 requires that the government assess any tax imposed within three years of the date the return was filed.31

ii. Section 6502 provides that once a timely assessment has been made (against the donor), the tax may be collected within 10 years after the assessment of the tax (from the donee).32

g. Gifts in Trust

i. Gifts in trust are ubiquitous in modern estate planning.

ii. The issue arises as to who is the donee of the gift?

iii. Who would be potentially personally liable for delinquent gift taxes, the trustee of the trust, or the beneficiary?

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28 IRM 35.2.2.7.1 (Sept. 24, 2012).

29 IRC §6901(c)(2), but not more than 3 years from expiration of the limitations of original transferor.

30 United States v. Botefuhr, 309 F.3d 1263, 1277 (10th Cir. 2007).

31 IRC §6501(a).

32 IRC §6502(a)(1).
iv. The statutory language of IRC §6324(b), which is the genesis of the personal liability for the gift tax, does not provide an answer.

1. Contrast to the personal liability provisions of the estate tax in IRC §6324(a)(2), which lists six categories of transferees of non-probate property, include trustees. Section 6324(b) only refers to donees.

v. In Marshall,33 a holding in the case was that the ex-wife, as beneficiary of a living trust, and not the trustee, was the donee who has personal liability under IRC §6324(b) for unpaid gift taxes.

1. The court relied on Supreme Court precedent finding that the trust beneficiaries were eligible for a gift tax exclusion under IRC §2503(b)34 thus the same conclusion should follow for transferee liability for gifts in trust.

2. Also, the court rejected the argument that the remainder beneficiary should be the donee.35

h. Discharge from Personal Liability under IRC §6905

i. An executor can obtain a discharge from gift taxes or the estate’s income taxes by filing a request for discharge under IRC §6905. This discharge concerns filed returns.

ii. Form 5495, Request for Discharge from Personal Liability Under Section 6905 is used.

33 United States v. Marshall, 798 F.3d 296, 308-10 (5th Cir. 2015). The Fifth Circuit distinguished the holding in Fidelity Trust Company v. Comm’r, 141 F.2d 54 (3d Cir.1944), which held the trust was the donee because the beneficiaries received gifts of a future interest. The case involved an insurance trust and the settlor had not yet died. In Marshall, the court held that the gift of a present interest was clear.

34 Helvering v. Hutchings, 312 U.S. 393 (1941)(gifts to a trust were gifts to the trust beneficiaries and that the trust beneficiaries were eligible for a gift tax exclusion under IRC §2503(b)).

35 Marshall, 798 F.3d at 303.
iii. The IRS has 9 months to notify the executor, or at the end of 9 months, without notice, the executor is discharged from liability for gift taxes or estate income taxes.\textsuperscript{36}

i. **Problem of Indirect Gifts**

i. Indirect gifts are referred to as a problem the potential gift tax liability is difficult to identify. The indirect gift usually does not have a corresponding gift tax return. Without a gift tax return, there is no running of the statute of limitations. As seen in *Marshall* and in the *Redstone* cases, years can elapse before a potential gift tax liability arises, much to the detriment of donees and donee transferee gift tax liability.\textsuperscript{37}

1. Since there is no expiration of statute of limitations when there is no gift tax return, the Service has the ability to assert a gift tax at any point in the future.\textsuperscript{38}

2. Likely there is lack of awareness of whether there had been a gift in an earlier year, or even if an issue of whether a gift tax return should have been filed.

   a. In *Estate of Sanford v. Commissioner*\textsuperscript{39} the trust was created in 1913, certain powers released in 1924 and a deficiency letter was issue in 1937, and a deficiency sustained in 1939. The issue would have barred years before if a gift tax return had been filed, even if no tax was shown as owing.

\textsuperscript{36} IRC §6905.

\textsuperscript{37} United States v. Marshall, 798 F.3d 296, 308-10 (5th Cir. 2015); Estate of E.S. Redstone, Deceased v. Comm’r, 145 T.C. No. 11 (2015)(some 40 years elapsed from indirect gift transaction and IRS assessment).

\textsuperscript{38} Griswold, The Statute of Limitations in Gift Tax Cases, 57 Harv. L. Rev. 906 (1944). Although styled as a Note, the abbreviation of E.W.G. place the authorship on Professor Erwin Griswold, as was subsequently treated in Developments in the Law of Statute of Limitations, 63 Harv L. Rev. 1177, 1179 n.27 (1950).

\textsuperscript{39} Estate of Sanford v. Comm’r, 308 U. S. 39 (1939).
b. In Redstone cases, the transaction on which the gift was based was some 40 years prior.

c. Potential gifts can arise from an array of possible transactions involving family members since the risks of indirect gifts, bargain sales and such are encountered, and those who might be determined to be donors might in good faith reasonably believe no gift tax return is required, and the lack of awareness of the transaction much less the requisite gift tax responsibility is even further out of the mind of donees.

d. Moreover, donees have potential transferee liability for any gift tax arising from any gift occurring during the year in question even if the transfer giving rise to the delinquent gift tax did not involve the donee being pursued.

ii. Professors Bittker & Lokken have succinctly described the problem of indirect gifts. Distilling their analysis here:

1. The gift tax is imposed on individuals.

2. Gifts made by entities, such as family partnership, trusts, etc. can be imputed to the controlling individual.

3. IRC §2511(a) states that the gift tax applies whether the gift is “direct or indirect”.

4. Bittker & Lokken categorize imputed and indirect gifts into three groups, which overlap:

   a. Gifts involving controlling or related entities.

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i. One of the oldest rules in gift taxation is that a gift by a corporation is treated as a gift by its shareholders. 42

ii. The below-value redemption in *E.T. Marshall*43 illustrates the point. Briefly, the August 2015 case arose from a corporate redemption in 1995 that the IRS treated as an indirect gift, in 1995. The redemption of the fathers’ stock occurred at below fair market value, with the result that the value of the stock owned by the remaining family members and wives (current or ex-wife) and their trusts increased in value – hence an indirect gift.

iii. Imputation of gifts by a partnership to the partners occurs also.

iv. Gifts made through trusts are not as straightforward as with corporations and partnerships. Most of the time, transfers by the trustee are not imputed to the grantor since transfers to the trust are usually completed gifts. 44 If the original transfer is not a completed gift, then trust distributions are appropriately imputed to the grantor.

b. Gifts involving ostensible intermediate entities.

i. A second form of indirect gift is transfers through intermediate entities that are in fact to be

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43 United States v. Marshall, 798 F.3d 296, 308-10 (5th Cir. 2015).

44 See Reg. §§25.2511-1(g)(1), (2) (transfer by trustee who has no beneficial interest in property is not gift by trustee). B. Bittker & L. Lokken, Federal Taxation of Income, Estates and Gifts, ¶121.1 n.10 (Thompson Reuters 2015).
disregarded. Thus, a gift made through an intermediary is to be attributed and reallocated to the true donor.45

ii. The regulations illustrate the point:

1. A transfer of property to B, who has an obligation of paying a commensurate annuity to C is a gift from A to C.46

2. Money is paid or property is transferred to B in consideration of B’s agreement to render a service to C is a gift from A to C, or from A to B and C.47

iii. Reciprocal trusts also illustrate the use of an ostensible relationship, which can be realigned. Thus, if A creates a trust for B’s children and under a prearrangement, B creates a trust for A’s children, then the realignment will result in A having created a trust for A’s children and B having created a trust for B’s children.48

iv. Contemporary examples of these concepts can be readily found in modern estate planning through the use of family limited partnerships. The courts appear to place emphasis on the form of the


47 Treas. Reg. §25.2511-1(h)(3). The adequacy of the consideration received by B is a conditional factor on whether there is a gift from A to B.

48 Comm’r v. Warner, 127 F2d 913 (9th Cir. 1942).
transaction, but in appropriate situations ignore the intermediate gift.\(^{49}\)

c. Discharge of Donee’s Debt.

i. A gift that has the effect of discharging the obligations of the donee can easily be characterized as a gift to the donee.

ii. A variation leading to the same result is the ubiquitous debt forgiveness owed by donee to donor, especially interfamily debt. The regulations cite debt forgiveness as an example of a gift.\(^{50}\)

iii. Another variation is the donor allowing the period of limitations on enforcement of a debt to lapse, thus resulting in a gift.\(^{51}\)

7. Collection of Delinquent Estate Taxes

a. Conceptual Idea of Gross Estate. The gross estate encompasses two broad categories of property:

i. Property titled in decedent’s name at death - probate property

ii. Property rights not necessarily in the decedent’s name described in IRC §2034-2042 - non-probate property.

\(^{49}\) Senda v. Comm’r, 433 F3d 1044, 1046 (8th Cir. 2006) (transfers of stock to partnerships, coupled with contemporaneous gifts of partnership interests to children were indirect gifts of stock to children, not gifts of partnership interests; Tax Court affirmed). See also Linton v. United States, 630 F3d 1211, 1213 (9th Cir. 2011), rev’g 638 F.Supp. 1044, 1046 (W.D. Wash. 2006). See Gerzog, Linton Reversed: Indirect Gift and Step Transaction, 130 Tax Notes 1607 (Mar. 28, 2011). There are abundant authorities illustrating the point that form of the transaction is a controlling factor in the outcome of the case. B. Bittker & L. Lokken, Federal Taxation of Income, Estates and Gifts, ¶121.1 n.18 et seq. (Thompson Reuters 2015).


\(^{51}\) Lang's Est. v. Comm', 613 F2d 770 (9th Cir. 1980) (gift resulted from allowing statute of limitations to run on enforcement of debt); Rev. Rul. 81-264, 1981-2 CB 185 (same).
b. **Executor Control.** Probate property is administered in probate, passes under decedent’s will and is subject to executor authority. Non-probate property, on the other hand, does not pass under the will, but by contract such as beneficiary form for a life insurance policy, an IRA or other benefit plan. Executor control does not extend to non-probate property.

c. **IRS Collection Strategies.** The IRS tools to collect the estate tax take into account these varied concepts of probate versus non-probate property. The IRS has lien rights over the assets in the gross estate and can choose to enforce those lien rights through foreclosure. The IRS can hold the executor responsible for payment of the estate tax, but naturally, the executor’s control only extends to probate property. The IRS can look to transferees of non-probate property for personal liability for the estate tax.

d. **Notices and CDP and Appeal Rights.**

i. Collection processes begin with notices of tax due. The usual form used by the Service is Form 10492, Notice of Federal Taxes Dues, which can also provide a copy of a Notice of Federal Tax Lien. This notice does not induce Collection Due Process rights, but is designed to provide the person in possession of estate assets an opportunity to pay the tax before commencement of collection proceedings.

ii. If the tax remains unpaid and the IRS starts its collection stage, then among other notices to be expected is Letter 1058, Final Notice of Intention to Levy. It is to be sent to the executor or administrator or absent an executor or administrator to the last known address of decedent, but not third parties in possession of estate assets.

iii. CDP rights emanate from the sending of Letter 1058, Final Notice. The person entitled to a CDP hearing is the “taxpayer” which is the estate as represented by the executor.52

1. Estate beneficiaries would not have CDP rights since they are not the taxpayer. The Letter 1058, Final Notice, would not be provided

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estate beneficiaries, who might expect to receive the Form 10492, Notice of Federal Tax Due and a copy of the Notice of Federal Tax Lien.\textsuperscript{53}

2. If a CDP request for hearing is made following the filing of a Notice of Federal Tax Lien, then the IRS will be attentive to whether there appears to be a dissipation of estate assets, or the collection or IRC §6324 estate or gift tax lien statute of limitations is approaching expiration, in which event levies (normal or jeopardy) or seizure might be considered.

e. **IRS Strategies for Collecting Estate Tax.**

i. The IRS strategies to collect a delinquent estate tax do not differ from the same strategies to collect a delinquent income tax. Thus, the list of available collection strategies listed below are commonly encountered in other collection contexts:\textsuperscript{54}

1. Providing Notice of Federal Tax Due to the executor or to persons holding assets that were included in the gross estate.

2. Filing a notice of general tax lien (IRC §6321 lien).

3. Levying or seizing probate assets.

4. Levying or seizing non-probate assets in possession of trustees of trusts or initial transferees.

5. Refer case to U.S. Department of Justice to bring suit to foreclose on tax lien.

6. Refer case to U.S. Department of Justice for IRC §6901 transferee assessment suit.

\textsuperscript{53} IRM 5.5.7.14 (Sept. 16, 2013).

\textsuperscript{54} IRM 5.5.7.14 (Sept. 16, 2013).
7. Refer case to U.S. Department of Justice for suit under 31 USC §3713 for fiduciary liability against executor or trustees.

ii. The IRS can elect to enforce its general tax lien (IRC §6321) or the estate tax lien (IRC §6324(a)) or seek to impose personal liability on estate transferees, or impose personal liability on the executor.

f. Tax Assessment Against Distributee or Transferee

i. Estate beneficiaries face potential liability if estate distributions are made before the estate satisfied tax liabilities.

ii. The IRS can enforce its tax lien (general tax lien per IRC §6321 or special estate tax lien per IRC §6324(a)), or seek to impose personal liability on beneficiaries using transferee liability.

iii. To pursue personal liability, the IRS can elect either to bring an action under IRC §6324(a)(2) or IRC §6901, which is probably more typical.

iv. The Tenth Circuit stated that IRC §6901 is only one method of collecting against transferees because,

\[
\text{the collection procedures of § 6901 are cumulative and alternative—not exclusive or mandatory.}^{55}
\]

1. As a result, “an individual assessment under [IRC] §6901 is not a prerequisite to an action to impose transferee liability under [IRC] §6324(a)(2).”^{56}

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55 United States v. Russell, 461 F.2d 605, 607 (10th Cir.1972). See also, United States v. Degroft, 539 F.Supp. 42, 44 (D. Md. 1981)(“ The collection procedures applying to transferees contained in I.R.C. §6901 are not exclusive and mandatory, but are cumulative and alternative to other methods of tax collection recognized and used prior to the enactment of Section 6901 and its statutory predecessors. Where assessment has been made properly against the estate, and it is established that the defendant is in fact a transferee or beneficiary, collection may be made pursuant to the general collection provision of Section 6502(a). . . .”).

56 United States v. Geniviva, 16 F.3d 522, 525 (3d Cir.1994). See also, United States v. Mangiardi, 2013-2 USTC ¶60,669 (S.D. Fla. 2013)(unreported)( citing Geniviva, similarly holds that assessment under IRC §6901 is not a prerequisite to the government's collection against a transferee. In this case the estate obtained six IRC §6161 extensions of the time for payment of tax, claiming that the stock market value declines following decedent’s death in 2000 prevented the estate from selling marketable securities without significant loss. Meanwhile, the estate actively traded in those assets and the beneficiaries paid themselves significant amounts in fiduciary fees. The court
2. Traditional transferee liability using IRC §6901 reaches estate transferees, which are defined to include a donee, heir, legatee, devisee, and distributee, and with respect to estate taxes.57

EXAMPLE: Decedent’s will gave $100,000 to Able, along with use of home and its contents. Another $30,000 was given to others and the residue was left to John. The estate was completely distributed in May 2010, the specific bequests were paid, and the amount distributed to the residuary beneficiary was in excess of any tax liability asserted by Service against decedent’s estates after the estate was distributed. HELD: Service could pursue the Able or John, or both, despite the adequacy of the residue to pay the tax liability.58

3. Also, a transferee under IRC §6901 includes “any person who, under section 6324(a)(2), is personally liable for any part of such tax.”59

8. Personal Liability for Unpaid Estate Taxes

a. Overview. There are three principal ways for the IRS to collect delinquent estate taxes. The rules differ for probate versus non-probate property.

i. Probate Property. The probate estate is all property of the decedent owned by the decedent, or titled in decedent’s name. The estate tax may be collected from the probate estate, if the property still remains in the

also held that the IRC §6161 extensions granted to the estate correspondingly extended the statute of limitation for assessing transferee liability on the estate's beneficiaries).

57 IRC §6901(h).

58 Taken from Peyton v. Comm’r, 44 B.T.A. 1246 (1941).

59 IRC §6901(h).
estate when the tax is assessed. Liability for a decedent’s estate tax is the responsibility of the executor.\textsuperscript{60}

1. Federal estate and gift taxes are usually assessed in the same manner as other federal taxes, against the decedent’s estate or the donor of the gift.
   
   a. For delinquent estate taxes, the executor of the estate is the person against whom the tax is assessed and from whom payment is normally expected.

   b. The usual process of notice, assessment and collection would be followed against the executor.

2. The general tax lien rules of IRC §6321 would be employed involving the filing of a notice of tax lien and enforcement of the lien.

ii. Non-Probate Property. Non-probate property is property included in the gross estate, but not in owned by decedent at death or not titled in decedent’s name at death, by virtue of IRC §§2034-2042. If the executor has paid decedent’s debts (except for taxes) and distributed the estate, and the probate estate is insufficient to satisfy the estate tax obligation, then a transferee liability is imposed on six categories of distributees.\textsuperscript{61}

1. Spouse

2. Transferee

3. Trustee

4. Surviving tenants

5. Person in possession of property by reason of the exercise, non-exercise or release of a power of appointment, or \\

\textsuperscript{60} IRC §2002; Treas. Reg. §20.2002-1.

\textsuperscript{61} IRC §6901(a)(1)(A)(ii).
6. Beneficiary who receives or has received as of the date of the
decedent’s death, property included in the gross estate under IRC
§§ 2034-2042, inclusive.

Example illustrating some estate beneficiaries cashing out
prematurely but held liable under IRC §6324(a)(2) for later
arising tax liability:

EXAMPLE: Decedent died in 1981. Decedent’s estate valued at
$446,000 was left to 3 children equally, with one child
appointed as executor. Children 2 and 3 received their
distributions of about $110,000 each and thought estate was
closed. Child 1 and the attorney failed to file an estate tax return
until 1985, some 4 years after death. IRS audited and assessed
substantial additional estate taxes of $275,000, plus penalties
and interest, which remained unpaid. Meanwhile, estate assets
values declined. By 1993, estate tax liability had grown to
$420,000. IRS sued all three children under IRC §6324(a)(1) for
liability up the amount of their inheritance, $110,000 each.
HELD: for IRS.⁶²

Example illustrating IRA beneficiary held liable under IRC
§6324(a)(2):

EXAMPLE: Decedent died in 2002. John received an estate
distribution of $70,000 cash and an IRA distribution of
approximately $526,000. The law firm did not file an estate tax
return until 2007. In September 2007, the IRS assessed
penalties for late filing and failure to pay in the amount of
$180,000. Family settlement agreement was entered into in
April 2008 pursuant to which $190,000 was distributed to
beneficiaries, and $101,000 was held by law firm, in escrow, for
payment of additional tax liabilities. By October 2009, tax
penalties and interest had grown to $241,000. IRS sued

⁶² United States v. Geniviva, 16 F.3d 522 (3d Cir.1994).
beneficiary and the court found the IRA beneficiary liable for unpaid estate taxes up to the amounts beneficiary received.63

iii. **Fiduciary Liability.** As added leverage, the executor can be held personally responsible for the delinquent estate tax for having made distributions from the estate instead of satisfying the estate tax first.64

b. **Break-down of IRC §6324(a)**

i. Section 6324(a)(1) imposes the estate tax lien on estate assets.

IRC §6324(a)(1):

(a) **Liens for estate tax.** Except as otherwise provided in subsection (c)—

(1) **Upon gross estate**

Unless the estate tax imposed by chapter 11 is sooner paid in full, or becomes unenforceable by reason of lapse of time, it shall be a lien upon the gross estate of the decedent for 10 years from the date of death, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien.

ii. Section 6324(a)(2) creates personal liability and uses few words to do it. To understand the statutory structure, the entire IRC §6324(b) text should be considered, but adding outline features along with subdivisions and cross references and captions to ease understanding. As with IRC §6424(b) discussed earlier, the caption to the statute is misleading. There is more going on in IRC §6324(a)(2) than first appears.


64 31 USC §3713(a).
IRC §6324(a)(2):

(2) Liability of transferees and others

[1] [Condition – if Estate Tax Not Paid] If the estate tax imposed by chapter 11 [Estate Tax provisions] is not paid when due,

[2] [Transferees Potentially Liable] then

[a] the spouse,

[b] transferee,

[c] trustee (except the trustee of an employees’ trust which meets the requirements of section 401(a)),

[d] surviving tenant,

[e] person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or

[f] beneficiary, who receives, or has received on the date of the decedent’s death, property included in the gross estate under sections 2034 to 2042, inclusive,

[3] [Limit of Personal Liability] to the extent of the value, at the time of the decedent’s death, of such property,

[4] [Creation of Liability] shall be personally liable for such tax.

[5] [Divestment of Lien for Transfers by Transferee] Any part of such property transferred by (or transferred by a transferee of) such

[a] spouse,

[b] transferee,

[c] trustee,
[d] surviving tenant,

[e] person in possession, or

[f] beneficiary,

to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and

[6] [Substitution of Like Lien on All of Transferee’s Property] a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person.

[7] [Exception for Purchasers and Holders of Security Interests] except any part transferred to a purchaser or a holder of a security interest.

c. Collection Against Transferees of Non-Probate Property

i. General Comments. Non-probate property is decedent’s assets passing outside the will and not within control of the executor of the estate.

1. These assets pass by a payable on death designation, a beneficiary form, or some external document to the decedent’s will. Thus, these assets are part of the gross estate for tax purposes, but not within the probate estate.

2. Accordingly, collection methods against a probate estate are not useful for non-probate property. The IRS must resort to transferee liability provisions of IRC §6324(a)(2) to collect delinquent estate tax.

ii. Transferee Liability Arising from Non-Probate Property. The transferee liability provisions of IRC §6324(a)(2) list six groups of persons as potential transferees from an estate. This statutory list derives from the grouping of non-probate assets included in the gross estate in IRC §§2034-2042.
1. The parallel structure of IRC §§2034 through 2042 is apparent from the phrase or word used in IRC §6324(a)(2) as the following chart illustrates.

<table>
<thead>
<tr>
<th>IRC §6324(a)(2) word or phrase</th>
<th>Parallel IRC provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spouse</td>
<td>§ 2034 - Dower or curtesy interests</td>
</tr>
<tr>
<td></td>
<td>The value of the gross estate shall include the value of all property to the extent of any interest therein of the surviving spouse, existing at the time of the decedent’s death as dower or curtesy, or by virtue of a statute creating an estate in lieu of dower or curtesy.</td>
</tr>
<tr>
<td></td>
<td>Predecessor: 1939 IRC §811(b).</td>
</tr>
<tr>
<td>Transferee</td>
<td>§ 2035 - Adjustments for certain gifts made within 3 years of decedent’s death</td>
</tr>
<tr>
<td></td>
<td>(a) Inclusion of certain property in gross estate. If—</td>
</tr>
<tr>
<td></td>
<td>(1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent’s death, and</td>
</tr>
<tr>
<td></td>
<td>(2) the value of such property (or an interest therein) would have been included in the decedent’s gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death,</td>
</tr>
<tr>
<td></td>
<td>the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.</td>
</tr>
<tr>
<td></td>
<td>Predecessor: 1939 IRC §811(c).</td>
</tr>
<tr>
<td>Trustee</td>
<td>§ 2038 - Revocable transfers</td>
</tr>
<tr>
<td></td>
<td>(a) In general. The value of the gross estate shall include the value of all property—</td>
</tr>
<tr>
<td></td>
<td>(1) . . .</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
</tr>
<tr>
<td>---------</td>
<td>-------------</td>
</tr>
<tr>
<td>Transferee and Fiduciary Liability Arising from Estate &amp; Gift Taxes</td>
<td>To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money’s worth), <em>by trust</em> or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power . . . by the decedent alone . . . in conjunction with any other person . . . to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3 year period ending on the date of the decedent’s death. Predecessor: 1939 IRC §811(d).</td>
</tr>
</tbody>
</table>
| Surviving Tenants | § 2040 - Joint interests  
The value of the gross estate shall include the value of all property to the extent of the interest therein held as *joint tenants with right of survivorship by the decedent and any other person, or as tenants by the entirety by the decedent and spouse*, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money’s worth. Predecessor: 1939 IRC §811(e). |
| Person in possession of property by reason of the exercise, non-exercise or release of a power of appointment, | § 2041 - Powers of appointment  
(a) In general. The value of the gross estate shall include the value of all property—  

. . .  

(2) Powers created after October 21, 1942  
To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent’s gross estate under sections 2035 to 2038, inclusive. |
Predecessor: 1939 IRC §811(f).

<table>
<thead>
<tr>
<th>Beneficiary who receives or has received as of the date of the decedent’s death, property included in the gross estate under IRC §§ 2034-2042, inclusive.</th>
<th>§ 2042 - Proceeds of life insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The value of the gross estate shall include the value of all property—</td>
</tr>
<tr>
<td></td>
<td>. . .</td>
</tr>
<tr>
<td>(2) Receivable by other beneficiaries</td>
<td>To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.</td>
</tr>
<tr>
<td></td>
<td>Predecessor: 1939 IRC §811(g).</td>
</tr>
</tbody>
</table>

iii. **Maximum Amount of Transferee Liability**

1. **Personal liability on transferees for unpaid estate taxes is limited to** the “to the extent of the value, at the time of the decedent’s death, of such property” to quote statutory language from IRC §6324(a)(2).

2. **Interest on the delinquent estate tax might be an exception to the statutory rule just stated.**
   
   a. **The Tax Court in Baptiste v. Comm’r,**\(^65\) **allowed interest to be assessed beyond the value of property received.**

   Taxpayers appealed to various circuits which came to different outcomes.\(^66\)

\(^65\) 100 T.C. 252 (1993).

\(^66\) Baptiste v. Comm., 29 F3d 433 (8th Cir. 1994)(IRC §6324 limitation applies to both tax and interest, citing IRC §6601(e)(1)); Baptiste v. Comm., 29 F3d 1533 (11th Cir. 1994)(transferee liability is a personal liability as opposed to a tax liability; accordingly, it is not constrained by the limitation under IRC §6324(a)(2)).
iv. Trust Beneficiary versus Insurance Beneficiary

1. The word “beneficiary” is the last one in the sequence of transferees listed and parallels IRC §2042, which includes certain life insurance in the gross estate.

2. As observed by Mr. Plumb, a life insurance company is not subjected to liability either as a transferee or a trustee. Personal liability is imposed on the insurance beneficiaries. On the other hand, when an inter vivos trust is includable in the gross estate, personal liability is not imposed on the beneficiaries but on the trustee. The soundness of this result has been praised in situations similar to the one before us, where the liability is asserted while the trustee still holds funds from which to indemnify himself, and while the beneficiary has only a contingent, or at best, a future vested interest.67

3. The term “beneficiary” has traditionally been interpreted to be a life insurance policy beneficiary, and not a trust beneficiary of an inter vivos trust.68 The Tax Court has interpreted the meaning of “beneficiary” as follows:

   We interpret section 827(b) to mean that only beneficiaries may be liable under this section for life insurance proceeds includible in the gross estate. Our interpretation in this respect appears to be fully in accord with the legislative intent of Congress when, by section 411 of the Revenue Act of 1942, the section was amended to read as it now appears.69

4. The Tax Court has also held the word “beneficiary” means an insurance policy beneficiary, not a trust beneficiary, by reference

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to legislative history:

The legislative history of section 6324(a)(2) reveals that for purposes of that section the term “beneficiary” is not used in its broad sense, but rather has a narrower, more restrictive meaning [as an insurance policy beneficiary].

5. The Eighth Circuit similarly held:

While cestui que trustent are ordinarily called “beneficiaries,” both in legal and every-day speech, yet it is obvious the use of the word “beneficiary” in this section applies only to insurance policy beneficiaries. . . . If a trust beneficiary is to be personally liable under this section, it must be because he is a “transferee.”

6. The argument has been rejected that because the trustee has transferred property to the trust beneficiary, then the trust beneficiary is liable as a transferee of a transferee.

v. Trustee of Trust Included in Gross Estate

1. If inclusion of inter vivos trust assets in a gross estate occurs by virtue of IRC §§2035, 2036, 2037 of 2038), then the responsible

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70 Garrett v. Comm’r., T.C. Memo 1994-70. See also Englert v. Comm’r, 32 T.C. 1008, 1016 (1959)(After reviewing the legislative history of section 827(b) of the 1939 Code, the Tax Court rejected the Commissioner’s broad interpretation of the term. It concluded that the personal liability imposed upon beneficiaries referred only to specific beneficiaries of life insurance, explaining that:

We believe, . . . Congress used the word ‘receives’ to take care of property received by persons solely because of decedent’s death such as insurance proceeds or property which was not in the possession of one of the persons described in section 827(b), as amended, at the moment of decedent's death, but who immediately received such property solely because of decedent’s death.”). Id. at 1016.

71 Higley v. Comm’r, 69 F.2d 160, 162-63 (8th Cir.1934).

72 Englert v. Comm’r, 32 T.C. 1008, 1016 (1959)(relying on Equitable Life Assurance Society v. Comm’r, 19 T.C. 264, 267 (1952), the Tax Court rejected this liability-by-secondary-transfer argument, applying a “more definite and restrictive meaning” to the term transferee.). Id.
transferee is the trustee, not the beneficiary.\textsuperscript{73}

2. In \textit{First Western Bank & Trust v. Commissioner}\textsuperscript{74} the Tax Court held that the taxpayer, who was the trustee, was personally liable as a transferee for the estate tax because it was in possession of property includable in decedent's gross estate at the date of death.\textsuperscript{75}

3. If trust funds are undistributed, then trustee has the funds with which to pay the tax and thus be protected from potential liability.

\textbf{Example: Trustee of marital trust held liable as transferee.\textsuperscript{76}}

Husband died 1968. He had established in 1968 a revocable trust, which divided into a Marital Trust and Family Trust. The wife was granted a general power of appointment over the Marital Trust, thus assuring that the Marital Trust assets would be includible in wife’s gross estate. Wife died in 1983. In wife’s will, she exercised the power of appointment in favor of her son. The son was also appointed executor of wife’s estate. Trustee of Marital Trust requested that wife’s estate file an estate tax return and include Marital Trust assets. Son failed to do so and so trustee of Marital Trust filed an estate tax return reporting property held in Marital Trust, per Treas. Reg. §20.6018-2.

\textsuperscript{73} See Rev. Rul. 75-553, 1975-2 CB 477 (bank trustee of revocable trust established by decedent by which income from trust was payable to settlor/decedent, while living, and then the trust corpus would be distributable to decedent’s estate, was not held liable as a transferee under IRC §6324(a) because no one other than decedent received a beneficial interest in trust property).

\textsuperscript{74} First Western Bank & Trust v. Comm’r, 32 T.C. 1017 (1959), modified on other grounds sub nom. Schuster v. Comm’r, 312 F.2d 311 (9th Cir.1962).

\textsuperscript{75} See Estate of Callahan v. Comm’r, T.C.Memo. 1981–357 (statutory notice of deficiency for unpaid estate taxes was properly and timely served on bank, trustee of revocable trust of decedent, which was liable under IRC §6324(a)(2) for delinquent estate taxes for residence titled in name of trust; that no estate was opened, nor any entity in the Estate’s name ever existed, nevertheless Bank was fiduciary to whom the Service was obligated to send statutory notice of deficiency for estate taxes.).

\textsuperscript{76} Taken from Estate of Govern, T.C. Memo 1996-434.
In 1992, trustee distributed Marital Trust assets to son per power of appointment and in accordance with state court order.

In 1995, the IRS asserted an estate tax deficiency against wife’s estate. Since wife’s estate and Marital Trust were distributed in full, IRS sought transferee liability against trustee of Marital Trust.

Tax Court held trustee liable under IRC §6324(a)(2). Trustee “should have paid, or sought permission from the state court to pay, decedent's estate's unpaid Federal estate tax liability that resulted from the inclusion of the Marital Trust property in decedent’s gross estate.”

4. Fiduciary might act in a multiplicity of roles, such as executor and trustee of revocable living trust and testamentary trusts with potential liability arising from the various fiduciary roles.77

vi. Statute of Limitations Applicable to Section 6324(a)(2) Transferee Liability

1. Most courts have indicated that the statute of limitations for the transferee's liability depends on the statute of limitations for the transferor's liability: so long as the government could bring a timely action against the transferor, its action against the transferee will be considered timely. Consequently, because the transferee's liability is derivative of the transferor’s, courts addressing the limitations period applicable to Section 6324(a)(2),

have looked at the generally applicable statutes of limitations created under § 6501 and § 6502 of the IRC, and they have reasoned that if the suit would be timely brought against the donor under these

77 E.g., Estate of Cutler v. Comm’r., 5 TC 1304 (1945), aff’d sub nom. Newton Trust Co. v. Comm’r, 160 F.2d 175 (1st Cir. 1947).
provisions, it will be considered timely against the donee or transferee.78

2. In Botefuhr, the Tenth Circuit uncoupled the 10-year limit on the special lien created under Section 6324 from the transferee liability limitations period, and held that Section 6502 established the statute of limitations for holding a transferee liable.79


a. Overview.

i. Risk of Executor Liability.

1. Executor’s Duties. Basically, an executor performs three tasks:

   a. Marshalling decedent’s assets;
   
   b. Pay decedent’s debts, and then
   
   c. Fulfil decedent’s dispositive scheme.80

78 United States v. Botefuhr, 309 F.3d 1263, 1276 (10th Cir. 2007)(citing United States v. DeGroft, 539 F. Supp. 42, 44 (D. Md. 1981) (“The statute of limitations applicable to the personal liability established by Section 6324(a)(2) is not the ten year period set out in Section 6324(a)(1) but rather the... period provided in I.R.C.’s § 6502(a).”)).

79 United States v. DeGroft, 539 F. Supp. 42, 44 (D. Md. 1981). See also, United States v. Mangiardi, 112 AFTR2d 2013-5344, 2013-2 USTC ¶ 60,669 (SD Fla. 2013)(unreported)(10-year statute of limitations applicable to collection of unpaid estate tax from transferee under IRC § 6324; transferee's liability is derivative of transferor's and thus the statute of limitations is derivative); see also, United States v. Kulhanek, 755 F. Supp. 2d 659 (WD Pa. 2010) (United States filed suit against the children more than 10 years after the estate tax lien arose, but within the 10-year collection period as extended under IRC § 6503. Finding the suit timely, the court stated that “because the transferee's liability is derivative of the transferor's, courts addressing the limitations period applicable to IRC § 6324(a)(2) have looked at the generally applicable statutes of limitations created under § 6501 and § 6502 of the IRC, and they have reasoned that if the suit would be timely brought against the donor under these provisions, it will be considered timely against the donee or transferee.”

80 See J. Soled, Implications of Discovering Unreported Income, Improper Deductions, and Hidden Assets Upon a Taxpayer’s Death, 44 Ga. L. Rev. 697 (2010) is among the best of the academic writings on this subject and from which this part of the discussion is drawn. Professor Soled is a professor of taxation at Rutgers University.
2. **Paying Decedent’s Debts.** The second duty, the duty to pay decedent’s debts, is the focal point here. Tax debts are different from other debts and create a risk of executor’s personal liability.

   a. **Types of Tax Debts Potentially Facing Executor of a Decedent**

   i. Assessed taxes (income or gift) arising during decedent’s lifetime;

   ii. Unreported income (or improper deductions taken) upon which no tax has been assessed;

   iii. Unreported gifts upon which no gift tax return nor gift taxes have been assessed; and

   iv. Estate taxes of decedent’s estate.

   b. **Incentive for Executor to Satisfy Tax Debts First.**

   i. The federal priority statute, as will be discussed, creates a strong incentive for executors to discover and then pay these tax debts first, before paying other creditors and before distributing assets to beneficiaries.

   ii. Perhaps this incentive should motivate an executor to file amended tax returns.81 Professor Soled discussed this issue in his article cited above. While amended tax returns are not legally required, failure to do so might increase executor’s personal liability for violating federal priority statute.

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81 For an executor to amend a tax return, which had been filed jointly, introduces the need for spousal consent to an amended return arising from a joint return. The spouse may not consent. Absent consent, amended return is doubtful. Soled, supra, at 712-713. For cases discussing the filing of joint returns without one spouse's consent or signature, see generally Alford v. Comm'r, 38 T.C.M. 123 (1979); Wiener v. Comm'r, 30 T.C.M. 244 (1971); Januschke v. Comm'r, 48 T.C. 496 (1967); Helfrich v. Comm'r, 25 T.C. 404 (1955). Cf. Little v. Comm'r, 113 T.C. 474, 483 (1999) (concluding that fiduciary acting in good faith was not liable).
iii. Unpaid estate taxes are obviously within the scope of federal priority statute, but less clear is income taxes owed on unreported income, improper deductions, or hidden assets.

1. If the IRS has not pursued a tax deficiency for these items, then why should an executor be liable?

2. If these undiscovered taxes are a “claim” then, as Professor Soled writes, perhaps “executors are on notice that a potential tax liability exist.”

iv. Many cases highlight this issue and would lead to the conclusion that hidden taxes are a claim for purposes of the federal priority statute.

1. In *Viles v. Commissioner*, the administratrix's knowledge that a current IRS audit of the decedent's income tax returns might result in a tax assessment was sufficient to hold her liable for the unpaid tax debt.

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83 As Professor Soled writes, “Aside from the cases discussed in the text, many other opinions reach the same conclusion. See, e.g., United States v. Coppola, 85 F.3d 1015, 1023 (2d Cir. 1996) (holding executor personally liable for unpaid estate taxes because executor was on notice of estate's potential tax liability when he transferred estate assets, rendering estate insolvent prior to satisfying tax debt to United States); Bank of the West v. Comm'r, 93 T.C. 462, 474-75 (1989) (holding executor liable who “had knowledge of the unpaid tax, the delinquent filing of the estate tax return, and the failure to pay the tax shown on the return”); Leigh v. Comm'r, 72 T.C. 1105, 1111 (1979) (holding that executor's signature on amended estate tax return showed he had knowledge of tax liability).”

84 233 F.2d 376 (6th Cir. 1956).
2. In *Estate of Frost v. Commissioner*, the estate attorney's letter to the executor indicating that the "value of the estate ‘may be undertaxed’" was sufficient to put the executor on notice about potential tax liabilities and therefore to hold the executor liable for the unpaid tax debt.

3. In *New v. Commissioner*, the decedent's bank informed the executor that the decedent had failed to file income tax returns for the last five years of his life; on the basis on this knowledge, the court held the executor should have known about the tax liability and was liable for making distributions from the estate without satisfying the government's claim.

c. **Duty of Inquiry.** The touchstone of potential executor liability, therefore, is knowledge. If the burden of proof can maintain lack of knowledge of hidden tax liabilities, then executor personal liability can be avoided. The duty of inquiry becomes the essential issue.

ii. **Preference.** The federal insolvency statute, or federal priority statute, as it is sometimes referred to, or 31 U.S.C. §3713,

\[
\text{provides that when a person is insolvent or an estate has insufficient assets to pay all of its debts, priority must be given to debts due the United States.}
\]

---


86 48 T.C. 671 (1967).

iii. **Personality Liability.** Personal liability may be imposed upon a fiduciary of an estate in accordance with the federal statutes,\(^8\)

1. If the 31 USC §3713(a) priority applies, then a fiduciary is liable for distributions that violate federal priority.

2. 31 USC §3713(b) imposes personal liability on a fiduciary or representative of an insolvent person or estate if the fiduciary:

   a. has knowledge of the federal tax debt, and

   b. pays other debts before paying the priority tax claims.

3. Personal liability is limited to the value of the assets that the fiduciary distributes in violation of federal priority.

b. **Statutory Provision.**

   i. 31 USC §3713(a) and (b) provides that:

   \((a)(1)\) A claim of the United States Government shall be paid first when—

   \(\text{(A)}\) a person indebted to the Government is insolvent and--

   (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

   (ii) property of the debtor, if absent, is attached; or

   (iii) an act of bankruptcy is committed; or

   \(\text{(B)}\) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

\(^8\) 31 U.S.C. §3713(b) and IRC §6901(a)(1)(B).
(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.

c. Priority is established in subsection (a)(1), which has two parts:

i. Subsection (a) concerns one who owes the U.S. government money, but is insolvent.

ii. Subsection (b) deals with an estate of a decedent who owes the U.S. government money, but whose estate under the executor’s or administrator’s control, in short the personal representatives of the deceased debtor, is insufficient to pay all debts of the debtor/decedent.

d. The provisions of 31 USC §3713(a) do not of itself create liability since it only requires that “a claim of the United States Government shall be paid first.” The muscle behind the federal priority statute under Section 3713(a) is personal liability imposed on the fiduciary under Section 3713(b). In the words of the Third Circuit:

The purpose of imposing personal liability on estate representatives ‘is to make those into whose hands control and possession of the debtor’s assets are placed, responsible for seeing that the Government's priority is paid.'

Of course, ‘[i]n order for liability to attach, the executor must have knowledge of the debt owed by the estate to the United States or notice of facts that would lead a reasonably prudent person to inquire as to the existence of the debt owed before making the challenged distribution or payment.'

89 United States v. Tyler, 528 Fed Appx 193, 201 (3rd Cir. 2013)(citing King v. United States, 379 U.S. 329, 337 (1964)).

90 United States v. Tyler, 528 Fed Appx 193, 201 (3rd Cir. 2013)(citing United States v. Coppola, 85 F.3d 1015, 1020 (2nd Cir. 1996)).
e. The priority of a claim paid from an estate derives from IRC §3713(a)(1)(B). The fiduciary liability is imposed by 31 USC §3713(b). Combining the two provisions offers an understanding of the relationship between the priority regime and the personal liability:

\[(a)(1) \text{ A claim of the United States Government shall be paid first when—}\]

\[\ldots\]

\[(B) \text{ the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.}\]

\[\ldots\]

\[(b) \text{ A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.}\]

f. **Preferential Payment Required.** Under the plain language of 31 USC §3713(b), there is no fiduciary liability until a debt is paid “before paying a claim of the [U.S.] Government.” The courts have repeatedly held that 31 USC §3713 does not create a liability in favor of the U.S. government until a payment has been made violating the U.S. government’s priority.\(^{92}\)

g. **Identifying Fiduciaries**

i. The fiduciaries described in 31 USC §3713(b) are: “the estate of a deceased debtor, in the custody of the executor or administrator.”

ii. IRC §7701(a)(6) defines “fiduciary” to mean “a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.”

\(^{91}\) 31 USC §3713(a).

\(^{92}\) E.g., United States v. Fisher, 6 U.S. 358 (1805); In re Baltimore Pearl Hominy Co., 294 F. 921 (D. Md. 1923), rev’d on other gds 5 F.2d 553 (4th Cir. 1925); In re C J Rowe & Bros, DC-Pa, 18 F.2d 658 (W.D. Pa. 1927); United States v. Williams, 139 F. Supp. 94 (M.D.N.C. 1956); and Seaboard Surety Co. v. United States, 67 F. Supp. 969 ( Ct. Cl. 1946), cert denied, 67 S.Ct. 863 (1947).
1. A trustee outside the bankruptcy context can be held liable under § 3713(b).\(^{93}\)

iii. A title of the person is not determinative, but control is the decisive factor.\(^{94}\)

iv. Even a fiduciary with limited authority confronts risk of personal liability.\(^{95}\)

**h. Notice of U.S. Claim**

i. Knowledge of the federal claim is a requirement of personal liability.

ii. The government must show that the fiduciary had either actual knowledge or knowledge of such facts as would put a reasonably prudent person on notice as to the existence of the tax debt before making the challenged distribution or payment.

1. Actual knowledge, or

   a. IRS not required to make claim in probate proceeding.\(^{96}\)

   b. Erroneous legal advice on handling IRS claim is not a defense.\(^{97}\)

2. Deemed notice of U.S. claim.\(^{98}\)

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\(^{93}\) Want v. Comm’r, 280 F.2d 777, 782-833 (2d Cir. 1960) (“Clearly [the trustee] would be personally liable ....”).


\(^{97}\) United States v. Renda, 709 F.3d 472, 484–85 (5th Cir.2013); United States v. Marshall, 798 F.3d 296, 311-12 (5th Cir. 2015).

a. Deemed notice is actual knowledge of a fact that “would put a prudent person on inquiry as to the existence of the claim.”

b. This introduces the duty of inquiry, discussed above.

i. Payment of Debt

i. To be held personally liable for federal taxes, one requirement of 31 USC §3713(b) is that the personal representative must have paid a debt of the decedent or the estate prior to satisfying the claim of the U.S. government.

1. Courts liberally construe the term “debt” to include “a distribution of funds that is not, strictly speaking, the payment of a debt.”

ii. Examples of debts payment of which trigger personal liability:

1. Decedent’s last illness expenses.

2. Payment to an unsecured creditor.

3. State taxes.

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100 Want v. Comm’r, 280 F.2d 777, 783 (2d Cir. 1960); United States v. Coppola, 85 F.3d 1015, 1020 (2d Cir. 1996).


103 Rev. Rul. 79-310, 1979-2 C.B. 404 (state income taxes). For Texas inheritance taxes, see United States v. Blakeman, 750 F. Supp. 216 (N.D. Tex. 1990), rev’d on other gds, 997 F. 2d 1084 (5th Cir. 1993), opinion withdrawn in part, 1993 WL 13154094 (1993), cert. den. US, 510 U.S. 1042 (1994). Some argue that: “the payment of state estate taxes to states, such as Florida, which have a “pick up” tax would not constitute the payment of a ‘debt.’ However, the payment of estate taxes in excess of the federal state death tax credit would, in our opinion,
j. Asserting Personal Liability Against a Fiduciary

i. Methods. The IRS can assert personal liability against a fiduciary by either:

1. Filing a suit under IRC §7402(a) against the fiduciary in a federal district court, or

2. Issuing a notice of fiduciary liability to the fiduciary under IRC §6901(a)(1)(B). The notice gives the fiduciary the right to challenge the determination in the United States Tax Court.

3. The government may be able to bring an action on the bond that fiduciaries are often required to post to serve as a fiduciary. The government may also seek removal of the fiduciary for misconduct.

ii. Statute of Limitations

1. Generally, the statute of limitations for filing suit against a fiduciary under 31 USC §3713(b) is the same as the statute of limitations for collecting the underlying tax assessment.104

2. Some cases suggest that it may be possible to successfully assert a longer statute of limitations for filing suit under 31 USC §3713(b) against a fiduciary.105

3. The statute of limitations for issuing a notice of fiduciary liability to the fiduciary is the later of one year after the fiduciary liability arises or the expiration of the statute of limitations for collecting the underlying tax liability IRC §6901(c)(3).

constitute a “debt” payment.” W. Carroll, J. Randolph, Minimizing a Personal Representative's Personal Liability to Pay Taxes Part I, Florida B. J. 60 (Nov. 2004).

104 United States v. Motsinger, 123 F.2d 585 (4th Cir. 1941).

105 See United States v. Moriarty, 8 F.3d 329 (6th Cir. 1993)(6 years after right of action accrues, 28 USC §2415; “We agree with the United States that the statute of limitations for a claim under 31 U.S.C. § 3713(b) begins on the date the right of action accrues against a debtor's representative.”).
4. Note potential unlimited limitations arising from fraud.¹⁰⁶

iii. **Prejudgment Interest.** Although not favored, the district court’s equitable discretion in §3713 cases allow awards of prejudgment interest, thus adding considerable bite to the federal judgment.¹⁰⁷

**k. Role of IRC §6901**

i. If the U.S. government successfully imposed fiduciary personal liability under 31 USC §3713(b), the IRS would be allowed to collect by asserting personal liability of the fiduciary (i.e., the trustee) by use of the transferee liability provisions of IRC §6901(a)(1)(B), which provides:

(a) Method of collection.--The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) Income, estate, and gift taxes.—

... (B) Fiduciaries.--The liability of a fiduciary under section 3713(b) of title 31, United States Code in respect of the payment of any tax described in subparagraph (A) from the estate of the taxpayer, the decedent, or the donor, as the case may be.

ii. Section 6901(a)(1)(B) does not create independent tax liability, but rests on a claim of fiduciary liability under 31 USC §3713(b).

1. For there to be liability under 31 USC §3713(b) the government must prove that there has been a payment by a fiduciary in

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¹⁰⁶ IRC § 6501(c)(1).

¹⁰⁷ See, e.g. United States v. Read, 2016 WL 310721 (D. Conn. 2016)(influencing factors was trustee self-dealing, self-enriching with trust distributions). The Tax Court has declined to award pre-judgment interest against an executor, Singleton v. Comm’r., 71 T.C.M. 3127 (1996).
violation of the priority of the U.S. government, after notice was
given to the fiduciary of that priority.

2. Lacking such a payment, there can be no personal liability.

l. **Defenses.** A fiduciary's defenses to liability under 31 USC §3713(b) include:

   i. The fiduciary had no knowledge of the federal tax debt.

   ii. The estate was solvent when the distribution was made.

   iii. The statute of limitations on collection of the underlying tax and for
        asserting liability under IRC §6901 has expired.

   iv. The distributions made by the fiduciary were for claims over which the
       United States did not have priority.

m. **Exceptions**

   i. Judicial exceptions permit payment of certain classes of claims before the
tax debt, including administrative expenses, funeral expenses, and
   homestead or family allowances.

   ii. Administrative expenses are expenses incurred for the general welfare of
   creditors. Administrative expenses include:

      1. Court costs

      2. Reasonable compensation for the fiduciary and fiduciary's attorney

      3. Expenses incurred to collect and preserve assets.

      4. Taxes incurred by the estate during its administration should be
paid as an administrative expense of the estate.

      5. An example of disputes over exceptions to the personal liability of
31 USC §3713(b) is *United States v. Marshall*,\(^\text{108}\) when the
   fiduciaries unsuccessfully argued in favor of allowing (1) distribution of personal property from the estate, and (2) rent

\(^{108}\) 798 F.3d 296 (5th Cir. 2015).
payments on decedent's apartment, and (3) professional fees paid by estate to other charitable organizations.

iii. **Expenses of Last Illness.** The expenses of a decedent's last illness are a debt of the decedent and not entitled to priority under 31 USC §3713.109

iv. **Family Allowance**

1. The IRM provides an explanation of this limited exception:

   The family allowance is not considered an administrative expense of the estate. In limited circumstances, the Service can exercise discretion to allow payment ahead of a tax lien. Consideration needs to be given to circumstances such as whether there are minor children who do not have another parent to support them. For example, if the surviving parent has sufficient income, trust distributions or life insurance proceeds to support minor or incapacitated children, this payment would not be allowed ahead of the tax lien.110

v. **Effect of Tax Lien.** A federal tax lien, arising before death, continues in the property to which it attached and therefore is prior to funeral costs, the surviving spouse's exempt property allowance (widow's allowance) and any support allowances (for the surviving spouse and minor children during administration of the estate).

n. **Delay Estate Distributions.** Executors can wait to make estate distributions until limitations have lapsed.111

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110 IRM 5.17.13.5 (July 9, 2012).

111 Cf. Ill. Masonic Home v. Comm'r, 93 T.C. 145, 151 (1989) ("The transferee cannot be held liable for the transferor's tax if the expiration of the period of limitations has extinguished the transferor's liability before the assets are transferred.").
10. Final Distribution of Estate; Executor Discharge

a. A recommended step is for an executor to obtain a discharge of personal liability before making final distributions.\(^\text{112}\)

b. The disadvantage is delay in obtaining the administrative discharge.

c. To obtain a discharge for estate taxes, the executor makes a written application for prompt determination of estate taxes and for discharge. The IRS has 9 months after receipt of the application or 9 months after the estate tax return is filed.\(^\text{113}\) If IRS does not provide notice to executor within the 9 months, then the executor is discharged at the end of that period for any personal liability for deficiencies.

11. Conclusion

There is more to the subject of transferee and fiduciary liability arising out of estate and gift taxes than meets the eye.

\(^{112}\) IRC §2204.

\(^{113}\) IRC §2204(a) and Treas. Reg. §20.2204-1(a).
Transferee & Fiduciary Liability Arising from Estate & Gift Taxes

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Dallas Bar Association
June 6, 2016
Like an iceberg, more to it than meets the eye
IRS Tools to Collect Estate & Gift Taxes

- Traditional remedies
- Supplemental Remedies
- Personal liability of fiduciaries
IRS Tools to Collect Estate & Gift Taxes

Traditional Methods

• Assessment
• Tax Liens
• Levies

Against Executor
Against Donor
Transferee & Fiduciary Liability

Introduction

IRS Tools to Collect Estate & Gift Taxes

IRC §6901
- Transferee liability

Source of law
- State law
- Federal Debt Collection Act
Collection of Gift Tax

Two major IRS collection strategies

1. Traditional tax collection against donor
   - General tax lien on donor’s assets
   - Levy on donor’s assets
   - Foreclosure of lien against donor’s property
Collection of Gift Tax

Two major IRS collection strategies

2. Supplemental remedies

• General tax lien on gifted assets
• Personal liability of donee (and other third parties)
Transferee Liability Gift Tax: Donor

Donor primarily responsible

Donor responsible for gift tax return and tax

Donor’s death before paying gift tax

- Executor responsible

- Risk of personal liability on Executor
Transferee Liability Gift Tax: Donor

Donor primarily responsible

If donor deceased, third parties potential responsible

- Donees

- If no executor (muniment of title), then heirs, descendants

- If split gift – spouse is also liable
**Liens for Gift Tax**. Except as otherwise provided in subsection (c), unless the gift tax imposed by chapter 12 is sooner paid in full or becomes unenforceable by reason of lapse of time, such tax shall be a lien upon all gifts made during the period for which the return was filed, for 10 years from the date the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a purchaser or holder of a security interest shall be divested of the lien imposed by this subsection and such lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a purchaser or holder of a security interest.
(b) **LIEN FOR GIFT TAX.** Except as otherwise provided in subsection (c), unless the gift tax imposed by chapter 12 is sooner paid in full or becomes unenforceable by reason of lapse of time, such tax shall be a lien upon all gifts made during the period for which the return was filed, for 10 years from the date the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a purchaser or holder of a security interest shall be divested of the lien imposed by this subsection and such lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a purchaser or holder of a security interest.
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1. Exception

2. Chapter 12 – gift tax

3. Paid or barred by limitations

4. Lien

5. On all gifts for year

6. Lasts – 10 years

Except as otherwise provided in subsection (c), unless the gift tax imposed by chapter 12 is sooner paid in full or becomes unenforceable by reason of lapse of time, such tax shall be a lien upon all gifts made during the period for which the return was filed, for 10 years from the date the gifts are made.
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If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.
If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.

1. Tax not paid
2. Donee of gift
3. Personally liable
4. Limit – value of gift
(b) **LIEN FOR GIFT TAX.** Except as otherwise provided in subsection (c), unless the gift tax imposed by chapter 12 is sooner paid in full or becomes unenforceable by reason of lapse of time, such tax shall be a lien upon all gifts made during the period for which the return was filed, for 10 years from the date the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.

Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a purchaser or holder of a security interest shall be divested of the lien imposed by this subsection and such lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a purchaser or holder of a security interest.
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<tr>
<td><strong>1. Transfer</strong></td>
<td>Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a purchaser or holder of a security interest shall be divested of the lien imposed by this subsection and such lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a purchaser or holder of a security interest.</td>
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<td><strong>2. To purchaser or lender</strong></td>
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<td><strong>3. Divested of lien</strong></td>
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<td><strong>4. Attach to all donee property</strong></td>
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<tr>
<td><strong>5. Exception</strong></td>
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Two Tax Liens Available

1. General tax lien, IRC §6321

2. Special gift tax lien, IRC §6324(b)
Two Tax Liens Available

General tax lien, IRC §6321

Special gift tax lien, IRC §6324(b)
General Tax Lien IRC §6321

- Attaches to Donor’s assets
  - But not gifted property
- Notice of lien required to be filed
- Enforced in usual manner
- Limitations – IRC §6502
  - 10 years from assessment
Special Gift Tax Lien IRC §6324(b)

- Applies to all gifts during year
- No assessment required
- No requirement to file notice of lien
- Lien remains attached to gifted asset
- Lien lasts for 10 years, no extension
Both tax liens exist simultaneously

IRS can enforce both tax liens

IRS not required to enforce liens on donor first
Transferee Liability Gift Tax: Personal Liability

Donees personally liable

Powerful tax collection tool

Personal liability on donees
Donee liability limited to value of gift
Donor versus Donee?

IRS’ choice: donor or donee?
Means to enforce donee liability

1. IRC §6901 action against donee
   a. Assessment
   b. Collection same as tax

2. Direct action against donee
   a. No assessment against donee
Issues for Gift Tax Transferee Liability

1. Indirect gifts
2. Several liability of donees
3. Split gifts – risk to spouse
4. If revocable trust used, then special problems
5. If no gift tax return – no limitations
6. Cumulative nature of gift tax
Marshall, 798 F3d 296 (CA5-2015)

1. In 1995, corporate redemption of patriarch - undervalued.
2. IRS treated as indirect gift for rest of family.
3. Gift tax upheld against family members.
4. Including beneficiary of trust.

1. In 2013, IRS determined gift tax for the quarter ending June 30, 1972.
2. Family settlement agreement in 1972. Trusts were funded.
3. No gift tax returns—hence, no limitations.
4. Gift tax upheld – 41 years later.
Composition of Gross Estate

| IRC §2033 | Probate Estate + Non-Probate Estate = Gross Estate |
| IRC §2034-2042 | | |
Estate Tax: Probate vs Non-Probate Property

- Decedent
  - Probate Property
    - Will
  - Non-Probate Property
    - Contract

- Executor
- Transferee
Transferee Liability Estate Tax: Probate Estate

1. Pay taxes
2. Pay debts
3. Residue

Will
Executor
IRS
Beneficiaries
Execution of Estate:\n
1. First, pay taxes
2. IRS

IRS Collection Leverage:

- Tax collection from estate if assets undistributed
- File tax lien on estate assets (§6321) and enforce lien
- Personal liability on executor

[31 USC §3713]
No Executor control over non-probate assets

IRS Collection Leverage

- File §6901 suit against transferees
- Personal liability on transferees
  [IRC §6324(a)(2)]
Transferee Liability | Estate Tax: Early Distributions

Estate
$446,000

- $110,000 each

Child 1
Child 2

- Tax grew: - $275,000 tax, then $475,000

IRS
$110,000 each

United States v. Geniviva, 16 F.3d 522 (3d Cir. 1994)
Transferee Liability Estate Tax: IRA Beneficiary Liable

- Estate
  - Death 2002
  - Cash: $110,000
  - IRA: $526,000

2008 Family Settlement: $190,000 distr; $101,000 to IRS

- 2007 estate tax return
- Assessment $180,000; By Oct. 2009 $241,000

United States v. Whisenhunt, 2014-1 USTC ¶60,681 (N.D. Tex. 2014)
(2) Liability of transferees and others
If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees’ trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent’s death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent’s death, of such property, shall be personally liable for such tax. Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person, except any part transferred to a purchaser or a holder of a security interest.
(2) Liability of transferees and others

If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees’ trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent’s death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent’s death, of such property, shall be personally liable for such tax. Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person, except any part transferred to a purchaser or a holder of a security interest.
If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees' trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax.

1. Estate tax not paid

2. Transferees identified

3. Limit – value of property (at death)

4. Personally liable
If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees’ trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent’s death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent’s death, of such property, shall be personally liable for such tax.
Transferee Liability Estate Tax: Transferees

IRC §6324(a)(2) phrase

Spouse

Transferee

Trustee

Parallel IRC

§2034 – Dower or Curtesy Interests

§2035 – gifts within 3 years of death

§2038 – Revocable Transfers (trusts)
Transferee Liability Estate Tax: Transferees

**IRC §6324(a)(2) phrase**

- Surviving Tenants
- Possessor of power appt property
- Beneficiary

**Parallel IRC**

- §2040 – Joint Interests
- §2041 – Powers of appointment
- §2042 – Life Insurance Proceeds
(2) Liability of transferees and others
If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees’ trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent’s death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent’s death, of such property, shall be personally liable for such tax. Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person, except any part transferred to a purchaser or a holder of a security interest.
Transferee Liability Estate Tax: Section 6324(a)(2)

1. Property Transferred
2. By Transferee (or transferee of transferee)
3. To Purchaser or Lender
4. Lien divested
5. Like lien attaches
6. To Transferee’s Property

Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person, except any part transferred to a purchaser or a holder of a security interest.
Issues List

1. Premature estate distributions
2. Discovering prior tax debts
   ➢ Unfiled returns
3. Several liability on transferees
4. Tax lien issues
5. Limitations period
Executor’s Duty to Pay Taxes:

IRS Leverage:

31 USC § 3713 - Priority of government claims

(a)(1) Priority of U.S. claim -
(B) When probate estate is not enough to pay debts of debtor

(b) Personal liability of estate representative for unpaid U.S. claims
U.S. Proof under 31 USC §3713

1. Identify Executor (or control person)
2. Executor has knowledge of tax debt
3. Payment of debts other than tax debt
Defenses to 31 USC §3713

1. Not the Executor
2. Executor did not have knowledge of tax debt
3. Limitations have run
4. Payments by fiduciary were not claims for which U.S. had priority
1. IRC §2204(a) – Executor discharge from personal liability
2. IRC §2204(b)-other fiduciaries
3. Written application
4. After estate tax return filed
5. 9 month wait
6. Effect: Executor remains responsible, but no personal liability
Executor Discharge from Personal Liability

1. IRC §2204(d) – executor discharge from personal liability for adjusted taxable gifts
2. Attributable go good faith reliance on gift tax returns
3. Made more than 3 years before – not shown on returns
Executor Discharge from Personal Liability

1. IRC §6905 – executor discharge from personal liability for gift & income taxes
2. Written application
3. 9 month wait
4. Effect: Executor remains responsible, but no personal liability; discharge is not a release from tax liens
Yes, there is more to it than meets the eye
Tax Practice

Fiduciary and Transferee Liability Arising from Delinquent Estate or Gift Taxes: Part 1

By William D. Elliott

Recently some decisions have been issued by the Fifth Circuit and the Tax Court that bring to mind the subject of fiduciary and transferee liability arising from estate and gift taxes. There are many, many decisions involving the same issues, but the recent cases mentioned here are at least interesting in a prurient sense due to the prominence of the taxpayers, their fabulous wealth and oversized lifestyle.

The first case to mention, E. T. Marshall,1 offers a complete array of the issues of this column, fiduciary liability and transferee liability (or donee liability) of unpaid gift taxes of a fabulously rich Texas oilman whose choice of matrimonial partners distinguishes him. Although the facts are complicated; for purposes of this column the case involved an indirect gift arising from a stock redemption. The patriarch’s stock was redeemed in 1995 at below fair market value with the result that the remaining family stockholders saw their stock value increase; hence, the indirect gift. Some family members were trust beneficiaries; some were fiduciaries of estates and trusts of other family members. Liability was found under the gift tax transferee liability provisions of Code Sec. 6324(a)(2) and (b), trust beneficiaries were found to be donees liable under the gift tax transferee liability provisions just cited and fiduciary liability was found under the federal priority statute, Section 3713(b) of Title 31 of the U.S. Code,2 due to fiduciaries making distributions before satisfying the gift tax liability.

The second case is actually a couple of cases, both from the Tax Court involving the same prominent family. The first of the cases is E.S. Redstone Est., Deceased,3 and the second, S. Redstone,4 arose from the same facts. The striking fact of these two cases is that in 2013, the IRS determined a gift tax for the calendar quarter ending June 30, 1972, together with civil fraud penalties and negligence penalties. The taxpayer prevailed in the first of the two cases on the ground that transfers arising out of a 1972 family settlement agreement were not donative transfers. The second case was the opposite outcome—the court found the transfers were motivated by donative intent. Hence, a gift tax was upheld although the taxpayer prevailed on penalties relief. For purposes of this column, the salient point of the two cases is the long tail of potential gift tax liability. The fact that aged transactions of 40 years can give rise to contemporaneous gift tax liability and thus potential donee or transferee liability is a sobering thought.
These current cases illustrate the continuing risk associated with transferee and donee liability arising from estate and gift taxes, especially the gift tax since gift tax liability can arise years after the transaction, and fiduciary liability risk for fiduciaries, and not just executors of estates but also trustees of trusts.

Recently, some decisions have been issued by the Fifth Circuit and the Tax Court that bring to mind the subject of fiduciary and transferee liability arising from estate and gift taxes.

This column, being Part 1 of a series, considers fiduciary liability arising from delinquent estate or gift taxes. The next column, being Part 2, will consider transferee liability arising from unpaid estate or gift taxes under Code Sec. 6324(b)(2). Fiduciary liability arising from Code Sec. 6324 for delinquent estate or gift taxes also will be considered.

In the broader context, any fiduciary is subject to the risk of personal liability for income taxes, estate or gift taxes of the individual or entity for which the fiduciary acts. Modern estate and tax planning utilizes trusts extensively for individuals while living, as well as after death. Trusts are ubiquitous in modern estate planning, both for individuals while living and obviously after death. Individuals create trusts for their own benefit such as revocable management trusts which become central estate planning vehicles for the entire family and serve in the nature of will substitutes. It stands to reason, therefore, that trusts are omnipresent in the lives of many. Just as individuals become delinquent taxpayers, so it is that trusts can become liable for the array of taxes conventionally owed by individuals.

For a decedent, the risk of fiduciary liability could exist for income taxes for which the decedent was liable while living and which liability extends to the decedent’s estate, for gift taxes made by the decedent during life but unsatisfied at death, for income taxes owed by a trust beneficiary of the decedent during life, and even for taxes owed by the decedent as a transferee of another, perhaps parents of the decedent, in the nature of pyramiding of transferee taxes. The decedent at death could have been subject to delinquent estate taxes. The massive industry otherwise known as estate planning has increased to untold dimensions the use of trusts, family partnerships, limited liability companies and so on. This growth means that fiduciary liability has increased exponentially as well.

This discussion is limited to estate and gift taxes, but liability risk can exist for years. Further, since gift tax liability can arise even after death for matters existing years before death was seen in the two Redstone cases, the fiduciary’s scope of concerns for decedent’s tax liability can assume a period measured in not merely years, but decades. U.S. federal tax law provides only two bases for personal liability of a fiduciary for delinquent estate taxes of a decedent: a fiduciary can be personally liable for the making of a “preference” payment against the U.S. government or a trustee who is a recipient of the assets of a taxable estate.

1. Liability for a preference payment against the U.S. government requires, among other requirements, a payment made to another creditor in preference to a U.S. government claim, which payment was made by a fiduciary having notice of that claim.5

2. Liability against: (1) a recipient of the assets of a taxable estate or (2) one who holds assets includable in the gross estate of a taxable estate on the date of the decedent’s death, when the tax applicable to the assets received or held is not paid.6

A comparable set of provisions exists for gift taxes. If a gift tax is not paid, the donee of any gift is personally liable for the delinquent gift tax to the extent of the value of the gift.7

Preference for U.S. Government Claims and Fiduciary Personal Liability

The federal insolvency statute, Section 3713, provides “when a person is insolvent or an estate has insufficient assets to pay all of its debts, priority must be given to debts due the United States.”

Personal liability may be imposed upon a fiduciary of an estate in accordance with the federal statutes.8 Under the federal priority statute, a fiduciary “paying any part of a debt of ... [an] estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.”

Statutory Provision: Section 3713

The starting point is the federal priority statute itself, which is not located within the Internal Revenue Code, but in Title 31 USC, making the statute perhaps less obvious to the average practitioner. The statute is variously called the federal priority statute or the federal insolvency statute. It was enacted in the 18th century at the beginning of the U.S. government and thus is one of the longest tenured federal statutes. The overriding statutory purpose is to assure
priority payment of money owed to the U.S. government. The statute applies to all payments to the U.S. government but is pertinent here for the payment of federal taxes.9

The federal priority statute prohibits the payment of other claims in preference to those of the U.S. government. The statutory command is virtually absolute—the U.S. government is paid first. Specifically, 31 USC §3713(a) and (b) provide that:

(a)(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.10

There are two parts to Section 3713(a)(1). Subsection (A) concerns one who owes the U.S. government money but is insolvent. Subsection (B) deals with an estate of a decedent who owes the U.S. government money but whose estate under the executor’s or administrator’s control is insufficient to pay all debts of the decedent.

The provisions of Section 3713(a) do not of itself create liability since it only requires that “a claim of the United States Government shall be paid first.” The muscle behind the federal priority statute under Section 3713(a) is personal liability imposed on the fiduciary under Section 3713(b). In the words of the Third Circuit:

The purpose of imposing personal liability on estate representatives “is to make those into whose hands control and possession of the debtor’s assets are placed, responsible for seeing that the Government’s priority is paid.”11

Of course, [i]n order for liability to attach, the executor must have knowledge of the debt owed by the estate to the United States or notice of facts that would lead a reasonably prudent person to inquire as to the existence of the debt owed before making the challenged distribution or payment.12

The priority of a claim paid from an estate derives from Section 3713(a)(1)(B). The fiduciary liability is imposed by Section 3713(b). Combining the two provisions offers an understanding of the relationship between the priority regime and the personal liability:

(a)(1) A claim of the United States Government shall be paid first when—

…

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

…

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.13

The first part in Subsection (a) is the priority, and the second part in Subsection (b) is the personal liability. These are part of a single statutory structure. Section 3713(a) was first enacted to collect on bonds for customs duties. Ten years after the original enactment, personal liability was added aimed at “those who frustrated the Government priority.”14

Under the plain language of Section 3713(b), there is no fiduciary liability until a debt is paid “before paying a claim of the [US] Government.” In the context of an estate or trust, this language applies when the fiduciary makes a distribution to beneficiaries before satisfying a federal tax claim. The courts have repeatedly held that Section 3713 does not create a liability in favor of the U.S. government until a payment has been made violating the U.S. government’s priority.15 Thus, a federal tax claim might not have priority over all other creditors, but the executor or trustee is ill-advised to pay any other creditors or make a distribution to beneficiaries before paying the federal claim.
Identity of Fiduciaries

The fiduciaries described in Section 3713(b) are “the estate of a deceased debtor, in the custody of the executor or administrator.” Code Sec. 7701(a)(6) defines “fiduciary” to mean “a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.” The Supreme Court has spoken to importance of the person being in control:

The generality of the language is significant. Taken together, these sections mean that a debt due the United States is required first to be satisfied when the possession and control of the estate of the insolvent is given to any person charged with the duty of applying it to the payment of the debts of the insolvent, as the rights and priorities of creditors may be made to appear.\(^{16}\)

The common characteristic of persons liable under Section 3713(b) is “that they are given possession and control of assets of debtors and are charged with the payment of debtors’ obligations.”\(^{17}\) Courts interpret the term “representative” broadly. “[O]ne need not be a personal representative to come within the coverage of” [Sec.] 3713(b); the “decisive” factor “is the element of control over the assets.”\(^{18}\)

Whether a fiduciary operating under close court supervision with limited discretion comes within the scope of personal liability was considered in King.\(^{19}\) The fiduciary in that case was King, President of the debtor corporation, as a distributing agent which appears to be comparable to a debtor-in-possession. The case involved a defense contractor, Seeley Tube & Box Company, Inc., which has filed bankruptcy. The U.S. government terminated two governmental contracts with Seeley and the U.S. War Department. Seeley was to be held liable for excess costs attributable to the termination and relating of the government contracts. A court-sanctioned plan was confirmed providing for Seeley to deposit funds from which distributions to creditors would be made by the bankruptcy referee. The distributing agent distributed substantially all of the funds in the deposit funds before the U.S. government claim was submitted and finalized. Litigation commenced over whether King, as distributing agent, had notice of the U.S. claim at the time he made the distributions from the fund. The United States brought suit against King for personal liability under the predecessor provision to Section 3713(b). King defended himself on the basis that he was merely a ministerial agent operating under close court supervision and therefore was an agent of the court, not personal representative of the debtor and therefore not within the category of “executor, administrator, or assignee, or other person.” The Supreme Court rejected King’s argument holding that he, as distributing agent, was a fiduciary for purposes of Section 3713(b). Despite King’s limited freedom to act without a supporting court order, the Court reasoned that King could approach the court at any time for changes to his authority.

The reasoning in King would extend to various estate fiduciaries operating under court supervision, such as guardians, estate administrator and the like.

Notice of U.S. Government’s Claim

Fiduciary liability requires that the fiduciary making the payment has notice of the U.S. government’s claim at the time of payment.\(^{20}\) For a fiduciary to have notice, the fiduciary must either have actual knowledge of the claim or be chargeable with knowledge of the claim.\(^{21}\) A fiduciary is chargeable with knowledge when the fiduciary has actual knowledge of a fact that “would put a prudent person on inquiry as to the existence of the claim.”\(^{22}\) This is often called “inquiry notice.”

Actual notice does not require that the U.S. government file a claim in the probate proceeding. Sovereign immunity forecloses the need for the government to submit a claim, as would be required for conventional creditors.\(^{23}\) In A. Summerlin, the Government had filed a claim in the probate action, but its claim was rendered void for being filed untimely under local probate law. The Supreme Court ruled that a state statute of limitations could not invalidate the Government’s claim. It appeared that the estate had not been distributed and the probate proceedings were still pending. Thus, the probate court retained control of the property of the estate and could, pursuant to the Supreme Court’s command, reverse its earlier disallowance of the Government’s claim and require it to be paid.

A different circumstance is present if the entire estate had been distributed, the executors had received their discharge and the probate proceedings were concluded before the government asserted its claim. Numerous cases exist holding an executor liable under Section 3713(b) (or its predecessor) for having distributed estate assets pursuant to a judicial decree of distribution without first paying the amount due the government, and even though the government had not filed a probate claim because in each instance at the time of making the distribution the executor was aware that the government was actively asserting its claim.\(^{24}\)

- In M. Viles, the Revenue Agent has advised the executrix of his computation indicating further tax liability and had suggested that no distribution should be made of the remaining assets until settlement of such tax liability.
In *M.H. Weisburn*, the IRS filed with the executor a proof of claim for the back taxes due from the decedent, but she nonetheless sought and obtained a confirmation of her account and a decree of distribution, which ignored the Government’s claim.

In *E.B. Munroe*, the executrix had been negotiating with representatives of the IRS for settlement of liability for back income taxes due from the decedent.

The purpose of imposing personal liability on estate representatives “is to make those into whose hands control and possession of the debtor’s assets are placed, responsible for seeing that the Government’s priority is paid.” The Fifth Circuit has declined to follow *Little* on the issue of reliance of erroneous legal advice. Lack of actual knowledge of the government’s claim by the executor or trustee does not end the inquiry. The requisite knowledge is expressed most often as:

> And the notice required is actual knowledge of such facts as would put a prudent person on inquiry as to the existence of the claim of the United States.

A decision representing an outer marker on the issue of indirect knowledge is *Vibradamp Corp.*, when the issue in the case arose from a guarantee that the decedent, Walter Muller, and his brother, Frank Muller, had executed in 1951 to the government to secure performance of a government contract for manufacturing items for the Navy. *Vibradamp Corp.* and the Navy disagreed over adjustments to the contract on account of the Navy being dissatisfied with the manufactured items. The dispute lingered for years, until 1957, when an agreement was reached that *Vibradamp Corp.* owed the government some $663,000. In 1952, the Muller brothers sold their stock in *Vibradamp Corp.*, which was resold a couple of times in the intervening years. Walter Muller died in 1961. Frank Muller and a corporate trust company were appointed executors of Walter’s estate. In 1965, pursuant to a final decree of distribution issued by the California probate court, the executors distributed Walter’s estate to Frank and the corporate trust company as trustees of the testamentary trust created by Walter’s will. At no point had the government filed a claim in Walter’s probate.

The district court framed the issues thusly:

> However, the question still remains whether the Government may remain silent throughout the course of probate and while the estate is distributed pursuant to the order of the probate court, and then hold the executor personally liable for not having paid the Government’s claim before making distribution, irrespective of his awareness of such a claim. … In the present case, the Government’s claim stems from a guaranty executed by the decedent in 1951, and repeatedly and erroneously told the executor that there was no tax liability. When he learned that the taxes were indeed owed, the executor offered to pay the remainder of the estate’s assets to the IRS in settlement of the claim. The Tax Court determined that the executor of the estate could not be held personally liable for the debt owed the government because he did not have “the requisite knowledge at the time he was dispersing funds to have knowingly disregarded debts due to the United States.”

The majority view appears to be that a representative’s actual knowledge of a federal claim is sufficient, notwithstanding that representative’s reliance on the erroneous advice of counsel as to how to address the claim. Several examples illustrate the lack of an exception for reliance on professionals:

Corporate officer personally held liable for distribution when he was aware of the existence of a government claim but relied on the erroneous advice of corporate counsel that the corporation had sufficient assets to pay it.

Executor held personally liable for unpaid estate taxes, even though a formal deficiency notice had not yet issued at the time of the transfer, because his informal discussions with the IRS put him on notice of the tax liability.

Executrix held personally liable for distribution, even though she relied on her tax attorney to handle the tax liabilities of the estate, because she had actual knowledge of the tax liability.

Corporate officers held personally liable for distributions, even though they had been advised by their attorneys that they had a right to repayment, because they were on notice of the outstanding mortgage held by the government.

Corporate officer held personally liable despite advice of attorney that the U.S. Government’s claim should be handled in the Court of Federal Claims and did not require any action by the officer; thus, corporate officer was under mistaken impression that the claim was invalid.

In *W.D. Little*, the executor had no prior experience with the administration of estates when he received notice of potential income tax liabilities of the estate. The executor forwarded this information to the estate’s attorney and asked for advice. The attorney, however,
the complaint asserts that the executors “… knew or should have known of the plaintiff’s claim against the estate of Walter Muller.” 37

One of the two guarantors, Frank Muller, was executor and trustee of Walter’s estate and testamentary trust, but the court did not believe this fact alone triggered the requisite notice:

Frank Muller, of course, knew of the guaranty that he executed in 1951, but it is not at all certain that he was mindful of it at the time of distribution; and even if he was, it does not follow that he thought of it, or should have thought of it, as constituting a potential basis for a claim of a currently existing debt due to the Government. 38

The court concluded that there was no fiduciary liability under the predecessor to Section 3713(b) on account of failure of notice of the government claim.

It is worthy of note that “actual notice of the government’s intention” to assert liability is much different than recollection of the execution of a twelve year old guaranty and awareness of the possibility that it might form the basis of a claim. 39

Payment of Debt

To be held personally liable for federal taxes, one requirement of Section 3713(b) is that the personal representative must have paid a debt of the decedent or the estate prior to satisfying the claim of the U.S. government. Payment of the following kinds of debts will trigger personal liability:

- Decedent’s last illness expenses 40
- Payment to an unsecured creditor 41
- State income taxes 42
- State inheritance taxes 43
- Local tax lien (where no action taken to attach to property before taxpayer became insolvent) 44

Collection of Personal Liability Amount

If the U.S. government successfully imposed fiduciary personal liability under Section 3713(b), the IRS would be allowed to collect by asserting personal liability of the fiduciary (i.e., the trustee) by use of the transferee liability provisions of Code Sec. 6901(a)(1)(B) which provides:

(a) Method of collection.—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) Income, estate, and gift taxes.—

…

(B) Fiduciaries.—The liability of a fiduciary under section 3713(b) of title 31, United States Code in respect of the payment of any tax described in subparagraph (A) from the estate of the taxpayer, the decedent, or the donor, as the case may be. 45

Code Sec. 6901(a)(1)(B) does not create independent tax liability but rests on a claim of fiduciary liability under Section 3713(b). For there to be liability under Section 3713(b), the government must prove that there has been a payment by a fiduciary in violation of the priority of the U.S. government after notice was given to the fiduciary of that priority. Lacking such a payment, there can be no personal liability.

Limitations on Assessment Required for Trustee Personal Liability

Before the IRS can assert liability against a trustee (or any other person) for a decedent’s estate tax liability it must first assess the liability against the estate and provide notice. Once assessed, then the IRS can attempt to collect the tax liability. Without assessment, the IRS cannot collect the tax liability.

Limitations from the Passage of Time

Generally speaking, the IRS may not assess a tax against a taxpayer later than three years after the taxpayer files the return. 46 In instances of transferee liability assessed against a fiduciary under Code Sec. 6901, the IRS is provided with one additional year in which to assess tax. 47

As an exception to the general rules just stated, the IRS may assess taxes at any time regardless of when or how long ago the estate tax return was filed if the IRS proves that the Estate Return was false or fraudulent. 48 To sustain the argument that an estate return was false or fraudulent, the IRS would be required to persuade a court that the executor of the estate prepared and filed the estate return with a willful intent to evade tax.

The IRS would generally be entitled to collect against fiduciaries and transferees for a period of 10 years from the date of the assessment. 49
Limitations from the IRS Closing Letter

At the conclusion of the review of the estate return, the IRS often issues the IRS closing letter. The IRS closing letter has the legal effect of finally closing the estate and barring the IRS from making any additional tax assessments attributable to the estate or estate return.

During the limitations period, an IRS closing letter conclusively determines the tax liability and the estate tax liability cannot be reopened without proof of the type listed in Code Sec. 7121(b), but once limitations bar further assessment, as they do here, then IRS may not assess additional taxes for any reason, including reopening the IRS closing letter, without first overcoming the period of limitations, e.g., by proving that the executor committed fraud.

Lack of Information Reports Without “Reasonable Cause”

An additional exception to the general period of limitations rules exists when a taxpayer has failed to file certain required information reports. These required reports include reports by U.S. taxpayers on their activities in connection with foreign entities, foreign financial assets and foreign trusts. Filings are required in connection with foreign trusts at the formation of a foreign trust or the transfer of funds to a foreign trust or the trust was includable in that U.S. person’s gross estate. The reports at formation or transfer are to be filed by the grantor or transferor U.S. person. The reports on account of a U.S. person’s death are to be filed by the executor.

This extension of the statute of limitations for failure to file reports does not apply if the failure to file the report or reports in question is on account of “reasonable cause” and not “willful neglect.”

Further, the statutory wording of Code Sec. 6501(c)(8) does not make clear that the statute applies to a Form 706, Estate Tax Return. The pertinent text of Code Sec. 6501(c)(8) provides:

(A) In general.—In the case of any information which is required to be reported to the Secretary pursuant to an election under section 1295(b) or under section 1298(f), 6038, 6038A, 6038B, 6038D, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title with respect to any tax return, event, or period to which such information relates shall not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under such section.

The statute specifies that “any tax imposed by this title” can be assessed until the required information is furnished, but the nine categories of information listed do not directly apply to an estate tax return. No published judicial opinion or any IRS administrative release could be located applying Code Sec. 6501(c)(8) to an estate tax return. Therefore, even if the nine categories of informational returns listed in Code Sec. 6501(c)(8) were not filed, it is doubtful that the statute of limitations for assessment of an estate tax liability could be extended beyond the three-year general limitations period of Code Sec. 6501(a).

Requirements for the IRS to Establish “Fraud”

To open the statute of limitations for fraud, the IRS must prove that the party preparing the estate return acted “with the intent to evade tax.” The burden of proof rests on the IRS.

Tax practitioners looking for tax risk would be well advised to keep a sharp eye on the fiduciary liability provisions of Section 3713, commonly called the “federal insolvency statute” or the “federal priority statute.” The IRS burden of proof would require the IRS to prove that the executor who prepared the estate return had fraudulent intent in preparing the return. The IRS would be required to prove that the executor possessed intent to evade tax, not merely a malicious or bad intent. Mere proof of a deficient or falsified return is insufficient. The hurdles on the IRS to prove fraud are significant.

Conclusion

Tax practitioners looking for tax risk would be well advised to keep a sharp eye on the fiduciary liability provisions of Section 3713, commonly called the “federal insolvency statute” or the “federal priority statute.” Located off the beaten path of the Internal Revenue Code, in Title 31 of USC, the statutory provisions, though among the earliest
of all U.S. statutes, nevertheless slip the mind. The government does not overlook the statute, however, and employs it regularly, as evidenced in the recent Fifth Circuit case of Marshall.63

The interpretation of the statute derives from case law and thus is more difficult to locate and understand. The personal liability provisions applicable to a fiduciary give the statute a bite. The language is outwardly simple and superficially understood: Under the federal priority statute, a fiduciary “paying any part of a debt of ... [an] estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.”64 Beneath the surface are issues that have the potential to impose personal liability on a fiduciary even many years after the event.

ENDNOTES


2 31 USC §3713(b).

3 E.S. Redstone Est., 145 TC No. 11, Dec. 60,434.

4 S. Redstone, 110 TCM 564, Dec. 60,467(M), TC Memo. 2015-237.

5 See 31 USC §3713(b).

6 See Code Sec. 6324(a)(2).

7 See Code Sec. 6324(b) (last sentence). The caption of the provision is “Lien for Gift Tax” which is the subject of the first sentence, but the second and last sentence concern transferee liability.

8 31 USC §3713(b) and Code Sec. 6901(a)(1)(B).

9 The legislative history is briefly described in E.S. King, SCt, 379 US 329, 334. See generally William D. Elliott, Federal Tax Collection, lien and levies (2nd ed. 2015), at Chapter 11.

10 The reference to “case under title 11” refers to a bankruptcy case under Title 11 of the U.S. Code. There has been no bankruptcy or Title 11 case in the subject of the first sentence, but the second and last sentence concern transferee liability.

11 31 USC §3713(a) and Code Sec. 6901(a)(1)(B).

12 The legislative history is briefly described in E.S. King, SCt, 379 US 329, 334. See generally William D. Elliott, Federal Tax Collection, lien and levies (2nd ed. 2015), at Chapter 11.

13 The reference to “case under title 11” refers to a bankruptcy case under Title 11 of the U.S. Code. There has been no bankruptcy or Title 11 case in the subject of the first sentence, but the second and last sentence concern transferee liability.

14 See Code Sec. 6324(a)(2).

15 See Code Sec. 6324(b) (last sentence). The caption of the provision is “Lien for Gift Tax” which is the subject of the first sentence, but the second and last sentence concern transferee liability.

16 There has been no bankruptcy or Title 11 case in the subject of the first sentence, but the second and last sentence concern transferee liability.

17 See Code Sec. 6324(a)(2).

18 There has been no bankruptcy or Title 11 case in the subject of the first sentence, but the second and last sentence concern transferee liability.

19 See Code Sec. 6324(a)(2).

20 There has been no bankruptcy or Title 11 case in the subject of the first sentence, but the second and last sentence concern transferee liability.

21 E.g., M. Viles, CA-6, 56-1 ustc ¶9539, 232 F2d 376; K. Weisburn, DC-PA, 43-1 ustc ¶9247, 48 FSupp 393; and E.B. Munroe, DC-PA, 46-1 ustc ¶9219, 65 FSupp 213.

22 King, SCt, 379 US 329, 334.

23 King, SCt, 379 US 329, 334.

24 King, SCt, 379 US 329, 334.

25 See generally A. Tyler, Minimizing a Personal Representative’s Personal Liability to Pay Taxes Part I, Florida B. J. 60 (Nov. 2004).

26 County of Wayne, CA-6, 67-2 ustc ¶9514, 378 F2d 671.

27 Code Sec. 6901(a)(1)(B).

28 Code Sec. 6501(a).

29 Code Sec. 6901(c)(3). Strictly speaking, the limitations period is the later of one year after the end of the period for assessment or the end of the period for collection of an assessed tax. While the period for collection is generally the longer, as the period for assessment of the original tax has passed without assessment, no collection of the original tax would be permitted.

30 Code Sec. 6501(c)(1)-(2), which provides:

(1) False return

In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) Willful attempt to evade tax

In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

31 Vibradamp Corp., DC-CA, 257 FSupp 931, 934.

32 Vibradamp Corp., DC-CA, 257 FSupp 931, 934.


36 J.N. Blakeman, CA-5, 92-2 ustc ¶50,455, 750 FSupp 216, rev’d on other gds by Blakeman, CA-5, 93-2 ustc ¶50,485, 997 F2d 1084, cert. denied SCt, 510 US 1042, 114 SCt 687. Some argue that “the payment of state estate taxes to states, such as Florida, which have a ‘pick up’ tax would not constitute the payment of a ‘debt.’ However, the payment of estate taxes in excess of the federal state death tax credit would, in our opinion, constitute a ‘debt’ payment.” W. Carroll & J. Randolph, Minimizing a Personal Representative’s Personal Liability to Pay Taxes Part I, Florida B. J. 60 (Nov. 2004).

37 See generally A. Tyler, Minimizing a Personal Representative’s Personal Liability to Pay Taxes Part I, Florida B. J. 60 (Nov. 2004).

38 County of Wayne, CA-6, 67-2 ustc ¶9514, 378 F2d 671.

39 Code Sec. 6901(a)(1)(B).

40 Code Sec. 6501(a).

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46 Vibradamp Corp., DC-CA, 257 FSupp 931, 935.

47 Vibradamp Corp., DC-CA, 257 FSupp 931, 934.

48 Vibradamp Corp., DC-CA, 257 FSupp 931, 935.

49 Vibradamp Corp., DC-CA, 257 FSupp 931, 935.

50 Vibradamp Corp., DC-CA, 257 FSupp 931, 934.

51 Vibradamp Corp., DC-CA, 257 FSupp 931, 934.

52 Vibradamp Corp., DC-CA, 257 FSupp 931, 935.

53 Vibradamp Corp., DC-CA, 257 FSupp 931, 935.

54 Vibradamp Corp., DC-CA, 257 FSupp 931, 934.

55 Vibradamp Corp., DC-CA, 257 FSupp 931, 934.

56 Vibradamp Corp., DC-CA, 257 FSupp 931, 935.

57 Vibradamp Corp., DC-CA, 257 FSupp 931, 935.
conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact...".

51 See L.J. Toledano, CA-5, 66-1 USTC ¶9476, 362 F2d 243, L.L. Lowy, CA-2, 61-1 USTC ¶9350, 288 F2d 517.

52 Code Sec. 6501(c)(8)(A).

53 Code Secs. 1298(f), 6038, 6038A, 6038B, 6046 and 6046A.

54 Code Sec. 6038D.

55 Code Sec. 6048.

56 Code Sec. 6048(a)(3).

57 Code Sec. 6048(a)(4)(A) and (B).

58 Code Sec. 6048(a)(4)(C).

59 Code Sec. 6501(c)(8)(B).

60 Code Sec. 6501(c)(3)(I).

61 Code Sec. 7454(a). As tax liability is a civil, not criminal matter, the IRS must meet its burden of proof by "a preponderance of the evidence."


64 31 USC §3713(b).
Tax Practice

Fiduciary & Transferee Liability Arising from Delinquent Estate or Gift Taxes: Part 2

By William D. Elliott

This column is Part 2 of a series of columns on fiduciary and transferee liability issues arising from delinquent estate and gift taxes. Recent decisions by the Fifth Circuit and the Tax Court have highlighted these issues in notable ways.

E.T. Marshall Case

The first case to mention, *E.T. Marshall,* was discussed in Part 1 of this series, but for ease of reference for the reader, it is briefly described here again. The case was decided in the Fifth Circuit in August 2015 and arose from a corporate redemption of stock in 1995 that the IRS treated as an indirect gift by the decedent whose estate was subject to federal gift tax. The redemption of the decedent’s stock occurred at below fair market value, with the result that the value of the stock owned by the remaining family members and current or ex-wife and their trusts increased in value—hence an indirect gift.

The variety and complexity of the class of transferees or donees added to the texture of the case. The corporation was owned by:

- E.T. Marshall, the decedent;
- decedent’s ex-wife, Eleanor Pierce Stevens and at her death by her estate, of which E. Pierce Marshall, Sr. was the executor;
- living trust for the benefit of decedent’s ex-wife Eleanor Pierce Stevens, with four sub-trusts including a Grantor Retained-Income Trust and a Charitable Remainder Annuity Trust, of which Finley Hilliard was the trustee;
- decedent’s son, E. Pierce Marshall, Jr. (and his estate);
- decedent’s daughter-in-law, Elaine Marshall;
- trusts for decedent’s grandsons, Preston Marshall and E. Pierce Marshall, Jr.; and
- all potential transferees or donees.

In 2008, the Tax Court decided that the decedent’s estate was the donor of the indirect gifts and thus was deficient in gift taxes for the year 1995—the year of the under-valued stock redemption. In 2008, with the donor not paying the gift tax, the IRS also assessed unpaid donor gift tax against the donees, which remained unpaid. In 2010, the government brought suit against the donees for the unpaid gift tax liability. In addition, the government brought suit against executors and
trustees of the ex-wife’s estate and trustee of various trusts, claiming violations of the Federal Priority Statute under 31 USC §3713 for distributions from the decedent’s estate and trusts before tax liabilities were satisfied.

For delinquent gift taxes, the risks include personal liability imposed on donees.

The district court found that:
1. The ex-wife, Eleanor Pierce Stevens, was a donee, even though she was a beneficiary of a living trust.
2. The liability of donees arising under Code Sec. 6324(b) was an independent tax liability apart from gift tax liability of the decedent’s gift tax liability as donor and was subject to interest under Code Sec. 6601.
3. Donees incurred interest on the independent donee gift tax liability.
4. The donees’ independent liability under Code Sec. 6324(b) was not capped at the value of the gift.
5. The fiduciaries were personally liable for the debts that they, as executors and trustees, paid before paying the gift tax liability; the court held that the fiduciaries had knowledge of the federal tax claim which put them on notice of the existence of the unpaid tax claim.

The parties had earlier stipulated that there was an indirect gift and the amount of the indirect gift.

The Fifth Circuit decision in Marshall is unusual in a few ways. First, the court’s decision handed down in August 2015 was actually its second opinion. The Fifth Circuit withdrew an earlier opinion handed down on November 10, 2014, and substituted the new opinion. Second, the decision was bifurcated. The majority opinion written by Judge Prado decided the issues pertaining to the ex-wife of the decedent and the fiduciary liability issues, but Judge Prado dissented on the issue of whether donee liability is capped, leaving Judge Owen to write for the two-judge majority on this issue.

1. The ex-wife of the donor-decedent-husband was a donee of the 1995 indirect gift of the under-valued redemption stock, even though she was the beneficiary of a trust that held the stock. The ex-wife had donee liability for the unpaid.
2. The executor of the ex-wife’s estate and the trustee of her living trust were personally liable for distributing funds from her estate and trust before satisfying the federal gift tax liability of the donor-decedent-husband.
3. In the part of the decision that was a split decision, the majority of the panel held that the donee’s liability for the donor’s unpaid gift tax and interest is capped by the amount of the gift. The minority thought that donee liability was not capped.

The logic of the majority panel on the capping issue was in three parts. First, the court felt the natural language of Code Sec. 6324(b) compelled the result:

If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.

The court felt this wording led to the conclusion that donee’s personal liability is capped at the amount of the gift. Second, the meaning of “tax” includes interest, a point conceded by the government. Third, the court found support from other courts that have held the donee’s liability is capped.

Redstone Cases

The second case is actually a couple of cases both from the Tax Court involving the same prominent family. The first of the cases is E.S. Redstone Est., and the second is S. Redstone, both arising from the same fact set. The striking fact of these two cases is that it was not until 2013 that the IRS determined a gift tax for the calendar quarter ending June 30, 1972, together with civil fraud penalties and negligence penalties. The taxpayer prevailed in the first of the two cases on the ground that transfers arising out of a 1972 family settlement agreement were not donative transfers. The second case was the opposite outcome—the court found the transfers were motivated by donative intent. Hence, a gift tax was upheld, although the taxpayer prevailed on penalties relief. For purposes of this column, the salient point of the two cases is the long tail of potential gift tax liability. The fact that aged transactions of 40 years can give rise to contemporaneous gift tax liability and thus potential donee or transferee liability is a sobering thought.

Legal Framework for Transferee and Fiduciary Liability for Estate and Gift Taxes

With these cases in mind, a brief review is appropriate of the legal framework for the transferee and fiduciary liability for unpaid estate and gift taxes. For many practitioners, there might be a general awareness of the risks...
of administering an estate that has potential delinquent estate taxes, but many practitioners are less familiar with:

- the risks of undiscovered gifts by the decedent (as seen in the Marshall case);
- the need to have clearance from the IRS on estate taxes and the delay in obtaining that clearance (also present in the Marshall case);
- the potential IRS lien rights being imposed on estate or gift assets and the surprise (and perhaps outright hostility against the practitioner) by spouse, heirs, estate beneficiaries and donees or heirs of deceased donees upon discovering, even years later, that the inherited or gifted assets are burdened with tax liens;
- the finer points of fiduciary discharge from liability; and
- many other issues.

Any practitioner administering an estate should keep a sharp eye on Code Sec. 6324.

Overview of Code Sec. 6324

The central statute for enforcing estate and gift taxes is Code Sec. 6324. It provides a three-pronged enforcement tool in that it:

- creates a tax lien on estate assets;
- creates transferee liability for delinquent estate tax on recipients of estate assets; and
- creates personal liability on fiduciaries who control estates and trusts of decedents and fail to pay estate and gifts taxes before making distributions.

The IRS can and does use the other tax collection enforcement tools to collect delinquent estate and gift taxes, such as imposing the general tax lien arising under Code Sec. 6321, but the power of Code Sec. 6324 is that it is a specifically targeted power aimed directly at estate and gift assets regardless of intervening years or unaware donees.

The statutory text is fairly easy to read and understand, but the main statutory title and subsection titles are slightly misleading. The title of Code Sec. 6324 reads:

26 U.S. Code § 6324—Special liens for estate and gift taxes

There is more going on in the statute than the creation of special estate or gift tax liens. Transferee liability for both estate and gift taxes is created. A special set of rules for gift taxes is found in subsection (b). Exceptions are carved out for varied financial interests of purchasers, lenders or mechanic lienors. Duration of the liens is specified in some respects.

Code Sec. 6324(a). Liens for Estate Tax

Code Sec. 6324(a)(1). Upon Gross Estate

Code Sec. 6324(a)(1) does create a tax lien for unpaid estate tax.

(a) Liens for estate tax. Except as otherwise provided in subsection (c)—

1) Upon gross estate

Unless the estate tax imposed by chapter 11 is sooner paid in full, or becomes unenforceable by reason of lapse of time, it shall be a lien upon the gross estate of the decedent for 10 years from the date of death, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien.

The statutory provision creates the tax lien, specifies the period of the tax lien to be 10 years and carves out an exception from the regime for court-ordered administrative expenses.

Many gift transactions are not even identified by donors, or their advisors.

Code Sec. 6324(a)(2). Liability of Transferees and Others

Subsection (a)(2), as will be discussed later, creates the transferee liability. The transferee liability provisions of subsection (a)(2) also contain a surprise for trustees receiving estate assets.

Trustees have personal liability for the unpaid estate tax, though the personal liability is capped, to use the statutory phrase, "to the extent of the value, at the time of the decedent's death, of such property." If trustees have distributed substantial amounts of trust property, then trustees potentially will be personally responsible for the unpaid estate tax.

The text of Code Sec. 6324(a)(2) is:

2) Liability of transferees and others

If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee
(except the trustee of an employees’ trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent’s death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent’s death, of such property, shall be personally liable for such tax. Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, or transferee of any such person, except any part transferred to a purchaser or a holder of a security interest.

As described in the discussion of the Marshall or Redstone cases, gift tax transactions can arise from disproportionate corporate redemptions, settlement agreements or a variety of intra-family business transactions.

Code Sec. 6324(a)(3). Continuance After Discharge of Fiduciary

If a fiduciary seeks discharge from personal liability under the provisions of Code Sec. 2204, then the estate tax lien imposed by Code Sec. 6324(a)(1) remains, except for assets sold to a purchaser or pledged to a holder of a security interest, in which case the lien attached to the proceeds of the sale or loan in the hands of the heirs, legatees, devisees or distributees.

The text of subsection (a)(3) reads as follows:

(3) Continuance after discharge of fiduciary

The provisions of section 2204 (relating to discharge of fiduciary from personal liability) shall not operate as a release of any part of the gross estate from the lien for any deficiency that may thereafter be determined to be due, unless such part of the gross estate (or any interest therein) has been transferred to a purchaser or a holder of a security interest, in which case the lien shall attach to the consideration received from such purchaser or holder of a security interest.

Code Sec. 6324(b). Lien for Gift Tax

Like many of the captions in this statute, this caption is misleading. There is more in subsection (b) than just lien creation. For delinquent gift taxes, a lien is imposed on all gifts made during periods for which a gift tax return was filed. The lien is to last for 10 years from the date the gift was made.

A secondary liability is imposed on the donee of the gift if the donor does not pay the gift tax to the extent of the liability. This provision was in dispute in the Marshall case discussed at the beginning of this column.

If a donee transfers property to a purchaser or holder of a security interest, then the gift tax lien is divested from the property so conveyed or pledged, and to the extent of the value of the gift, attaches to the property of the donee, except for that part transferred to a purchaser or holder of a security interest.

The text of Code Sec. 6324(b) reads:

(b) Lien for gift tax

Except as otherwise provided in subsection (c), unless the gift tax imposed by chapter 12 is sooner paid
in full or becomes unenforceable by reason of lapse of time, such tax shall be a lien upon all gifts made during the period for which the return was filed, for 10 years from the date the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a purchaser or holder of a security interest shall be divested of the lien imposed by this subsection and such lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a purchaser or holder of a security interest.\(^\text{10}\)

**Code Sec. 6324(c). Exceptions**

Comparable exceptions found in Code Sec. 6323 are created in subsection (c) for mechanic lienors, or the super-priority interests or liens found in Code Sec. 6323(b). The priority granted to interest and expenses for financing arrangements is extended to this provision.\(^\text{11}\)

The text of Code Sec. 6324(c) is:

\[\text{(c) Exceptions} \]

\[
\begin{align*}
\text{(1) The lien imposed by subsection (a) or (b) shall not be valid as against a mechanic's lienor and, subject to the conditions provided by section 6323(b) (relating to protection for certain interests even though notice filed), shall not be valid with respect to any lien or interest described in section 6323(b).}
\end{align*}
\]

\[
\begin{align*}
\text{(2) If a lien imposed by subsection (a) or (b) is not valid as against a lien or security interest, the priority of such lien or security interest shall extend to any item described in section 6323(e) (relating to priority of interest and expenses) to the extent that, under local law, such item has the same priority as the lien or security interest to which it relates.}
\end{align*}
\]

The practical effect of these exceptions in subsection (c) is to isolate and protect purchasers of estate or gifted assets or holders of security interests in estate or gifted assets from the ravages of the federal estate or gift tax lien. Let it never be said that the moneyed interests do not take care of themselves.

**Transferee Liability for Recipients of Estate Assets**

As mentioned above, Congress has created transferee liability for delinquent estate tax for the following class of persons:

- spouses,
- transferees,
- trustees,
- surviving tenant,
- those receiving property by virtue of the exercise or release of a power of appointment, and
- beneficiaries who have received the assets of an estate for which there is an outstanding estate tax liability. The transferee liability is personal liability.

A way of thinking about this class of personal liability is the triad of transferee liability:

- Transferee liability in equity (Code Sec. 6901)
- Transferee liability in law (Code Sec. 6324)
- Transferee liability by contract

The transferee liability introduced by Code Sec. 6324(a)(2) is the second category, transferee liability in law. The statute imposes the transferee liability—and thus it is transferee liability in law. There is no need for state fraudulent conveyance law to be invoked under subsection (a)(2), as is the case for Code Sec. 6901.

Estate tax transferee liability is not conditioned on the Service pursuing remedies against the estate, except as noted. The transferee's liability for estate tax deficiencies is a primary, not a secondary, obligation. The statute limits estate tax transferee liability by requiring there be a deficiency due from an estate, and that the estate tax transferee liability is limited by the value of the estate corpus received.\(^\text{13}\)

**Example illustrating some estate beneficiaries cashing out prematurely but held liable under Code Sec. 6324(a)(2) for later arising tax liability:**

**Example.** Decedent died in 1981. Decedent's estate valued at $446,000 was left to 3 children equally, with Child 1 appointed as executor. After expenses of administration and taxes were paid, Child 2 and Child...
3 received their distributions of about $110,000 each and they thought the estate was closed. Child 1 and the attorney failed to file a Form 706 estate tax return until 1985, some 4 years after death. The IRS audited and assessed substantial additional estate taxes of $275,000, plus penalties and interest, which remained unpaid. Meanwhile, Estate assets values declined. By 1993, estate tax liability had grown to $420,000. The IRS sued all three children under Code Sec. 6324(a)(1) for liability up the amount of their inheritance, $110,000 each. HELD: for IRS.14

Example illustrating IRA beneficiary held liable under Code Sec. 6324(a)(2):

Example. Decedent died 2002. The beneficiary received an estate distribution of $70,000 cash and an IRA distribution of approximately $526,000. The executor’s law firm did not file an estate tax return until 2007. In September 2007, the IRS assessed penalties for late filing and failure to pay in the amount of $180,000. A family settlement agreement was entered into in April 2008 pursuant to which $190,000 was distributed to the beneficiary, and $101,000 was held by law firm, in escrow, for payment of additional tax liabilities. By October 2009, tax penalties and interest had grown to $241,000.

Trust Beneficiaries Having Personal Liability as Transferees or Donees

A major holding in the Marshall case was that the ex-wife, as beneficiary of a living trust, was a donee who had personal liability under Code Sec. 6324(b) for unpaid gift taxes.

In the gift tax area, Code Sec. 6324(b) referred to the word “beneficiary” as referring to insurance policy beneficiaries, not trust beneficiaries. The Fifth Circuit decided that for estate tax transferee purposes references to a beneficiary means a trust beneficiary.

Statute of Limitations for Personal Liability Arising from Code Sec. 6324(a)(2)

The transferee liability contained in Code Sec. 6324(a)(2) does not state explicitly a statute of limitations for the transferee personal liability. Few cases have considered the issue, but most that have done so indicate that

...have looked at the generally applicable statutes of limitations created under § 6501 and § 6502 of the IRC, and they have reasoned that if the suit would be timely brought against the donor under these provisions, it will be considered timely against the donee or transferee.15

In C.E. Botefuhr, for example, the Tenth Circuit uncoupled the 10-year limit on the special lien created under Code Sec. 6324 from the transferee liability limitations period and held that Code Sec. 6502 established the statute of limitations for holding a transferee liable.

Similarly, in J.C.M. DeGroft,16 the government sought to collect unpaid estate taxes from the transferees of the decedent’s estate pursuant to Code Sec. 6324(a)(2). The defendant objected, arguing that, because the 10-year limitation period applicable to special liens under Code Sec. 6324(a)(1) had expired, an action under Code Sec. 6324(a)(2) was also untimely. Rejecting this position, the court held:

[A] transferee is personally liable for the tax: there is no need to bring an action to recover the actual property transferred to which the special lien has attached. If the special lien expires before the government sues to enforce it, or if the government sues under Section 6324(a)(2) without reference to that lien, and that lien expires, then it will have lost the security of that lien. However, this does not vitiate its separate action, as here, to collect on the personal liability imposed by Section 6324(a)(2).17

The court concluded, therefore, that the government’s transferee action was timely despite the prior expiration of the Code Sec. 6324(a)(1) special lien.18

A couple of recent cases highlight the lengthy period of enforcement of Code Sec. 6423(a)(2) transferee liability. These cases are not trailblazers but illustrate how long a period the IRS has to enforce the transferee liability. In H.R. Anderson,19 the facts are sparse in the opinion, but the case arises in an action by the government to enforce tax liabilities of an estate against the estate’s personal
representatives and beneficiaries, who moved to dismiss the enforcement action, which motion was denied by the Florida district court.

The motion to dismiss was premised on the argument that the government’s action, filed on May 24, 2011, was time-barred by the 10-year limitations of Code Sec. 6502(a)(1). The court easily determined that the action was timely. Code Sec. 6502(a)(1) provides for the 10-year collection limitations period and was amended in 1988 to provide that:

If a timely proceeding in court for the collection of a tax is commenced, the period during which such tax may be collected by levy shall be extended and shall not expire until the liability for the tax (or a judgment against the taxpayer arising from such liability) is satisfied or becomes unenforceable.\(^20\)

Once the suit was filed by the government, the 10-year statute of limitations period was extended continuously until the tax liability was satisfied or became unenforceable.\(^21\)

Two cases, *A.J. Kulhanek*\(^22\) and *M.G. Mangiardi*,\(^23\) involved limitation periods under actions brought under Code Sec. 6324(a)(2) after extensions of time were granted to pay the estate tax. In *Kulhanek*, the government brought suit under Code Sec. 6324(a)(2) more than 10 years after the estate tax lien under Code Sec. 6324(a)(2) arose, but within the 10-year collection period, as extended. The argument was made that since the extension of time to pay the estate tax was granted to the estate and not to the transferee, that the suspensions of the limitations period do not apply to the transferee, but this was rejected by the court reasoning that the transferee’s liability is derivative of the transferor’s liability. Thus, the limitations under Code Secs. 6501 and 6502, had the suit been timely if brought against transferor, also would have been timely against transferee.

In *Mangiardi*, there were several extensions of time to pay the estate tax due. The original tax assessment was August 20, 2001, and the last extension was to December 5, 2004. The Code Sec. 6502 collection period was thus extended to July 20, 2015. The argument was made that the extensions of time granted do not apply to the transferee, who has the independent tax liability from transferor, but the court again rejected the argument holding that transferee liability was derivative of transferor and so should be the statute of limitations. The court in *Mangiardi* also rejected the argument that transferee liability under Code Sec. 6324(a)(2) must first be brought under Code Sec. 6901. Following precedent, the court rejected any idea that Code Sec. 6901 is a prerequisite to Code Sec. 6324(a)(2) actions.\(^24\)

In the *Redstone* cases, the gift tax liability arose many years after the 1972 transaction that triggered the gift tax. In 2010 and 2011, the IRS, during an audit, developed the position that a gift tax return should have been filed in 1972. Since the donor had not filed a gift tax return following the 1972 transactions, then without a tax return, the statute of limitations remained open. To quote the Tax Court on this issue:

*Sumner [Redstone] did not file a Federal gift tax return reporting the 1972 transfer of stock to the children’s Trusts. The notice of deficiency, though issued 41 years after the transfer, was thus timely.*\(^25\)

**Years can elapse before the gift tax claim is even made, as illustrated in Redstone.**

Although the *Redstone* cases illustrate an extreme, unusual, example, the point for practitioners is that specific client fact situations can produce all kinds of issues. Latent gift tax issues are perhaps among the greatest of risks. Any family transaction has the risk of producing a potential gift tax issue.

**Personal Liability for Delinquent Gift Taxes**

Donees of gifts bear the risk of personal liability for unpaid gift tax on the gift. The statute imposes the liability and uses few words to do it. Code Sec. 6324(b) provides for this liability in the second sentence:

If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.\(^26\)

This liability is transferee liability at law. The liability imposed is a legal liability arising from the positive imposition of Code Sec. 6324(b). It does not require any reference to the fraudulent conveyance law of the various states.

The distinction between the lien and liability provisions of Code Sec. 6324(b) is clear. The first sentence creates a tax lien on gifted property. Then, separately in the second sentence, liability is imposed. Courts interpreting Code Sec. 6324(b) routinely analyze the personal liability component of Code Sec. 6324(b) as being independent from, and without reference to, the lien provision.\(^27\)
Donee's liability arises at the moment the donor fails to pay the gift tax. Perhaps then the more correct expression is that donee's liability is derivative, in the sense that the liability arises only after the donor fails to pay the gift tax when due.

Solvency of donor is immaterial. In contrast to conventional transferee liability, gift tax transferee liability derives from statute, Code Sec. 6324(b) (second sentence), imposing direct liability on the donee. The financial condition of donor is thusly irrelevant. The Third Circuit made this point succinctly:

"It is wholly immaterial to the enforcement of the legal liability whether the transfers rendered the donor insolvent or whether he remained solvent during the period of his enforceable liability for the tax."

Limitation of Gift Tax Transferee Liability

The donee-transferee has transferee liability for the unpaid gift tax, but the provisions carefully limit such liability to the extent of the value of the gift. The statutory phrase expressing the limitation is:

If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.

An interpretation question is when is the value of the gifted asset to be measured? Is the value a maximum limitation in the hands of the donee, even if the value rises or falls? Is the value a one-time measure and subsequent changes in the gifted property value a possible risk to the donee? The transference liability limitation in subsection (a) (2) for estate tax transference liability limits the transference liability risk "to the extent of the value, at the time of the decedent's death, of such property." The statutory language makes clear that estate tax transference liability is capped at the value of the pertinent property at the date of death, but the gift tax transference liability limitations does not use the limiting language. The implication from the absence of the limiting language in subsection (a)(2) is that the donee's limitation on liability is measured by the value of the gifted property at the time when the transference liability is asserted. If inherited property declines in value, then the risks on transferees diverge between subsections (a)(2) and (b). Estate tax transferees are at risk if property declines, since the value cap is measured at a one-time moment, the value at decedent's death. This is not apparently so for gift tax transferees.

No Need to Pursue Donor First

The trigger for gift tax transferee liability is the mere failure by the donor to pay the gift. No showing need be made that the IRS attempted to collect the gift tax from the donor. This point is somewhat counterintuitive. Donee liability does not require the IRS pursue the donor.

Common expression often refers to the donor as being primarily liable and the donee secondarily liable for the gift tax. Subject to various qualifications, tax liability is imposed "on transfers of property by gift." Gifts are defined as including transfers of property for “less than an adequate and full consideration in money or money's worth.” Generally speaking, the party that makes the gift, the donor, bears primary responsibility for paying any tax liability associated with the gift.

This expression about donor’s primary liability, however, is imprecise, as stated by the Eighth Circuit, and creates the false impression that the IRS must pursue collection against the donor before turning to the donee:

The argument is made here that the donor’s liability for the tax is primary and that of the donee secondary, and that no liability therefore should exist against a donee for any part of a tax which a solvent donor has not admitted in his return, until there has been a deficiency determination against the donor, in the manner and within the time provided by the statute . . . . If the donor fails to pay the automatically imposed tax when due, in accordance with the statute, no matter what the reason for his failure, there is an immediate and direct liability on the donee for the legally-owed tax, to the extent of the value of the gift.

Nowhere in its language does the statute make the liability of the donee contingent or dependent upon a formal determination of deficiency against the donor or upon any other steps to collect from him.

In a similar vein, the Tenth Circuit made the same point:

Indeed, once the donor fails to pay the underlying gift tax, the IRS may elect to collect the tax from either the donor or the donee, and need not take any direct action against the donor before pursuing the donee.

Transferee Liability for Indirect Gifts

Transferee liability for indirect gifts presents a difficult problem for practitioners. In Marshall, the indirect gift tax liability arose from a corporate redemption for less than
fair market value. Many practitioners might not even know about potentially gift-tax-generating transactions buried in the client’s facts especially if the client relationship is new.

Transactions involving family members introduce gift tax risks arising from part-gift, part-sale characterizations. The family might think that a transaction was at fair market value, but the IRS might argue otherwise and assert a gift tax.

If a gift tax return was not originally filed, such as in Redstone, then limitations will not bar a gift tax deficiency, even years later.

What if the donor died in the intervening period, and during estate administration the issue arises whether to make estate distributions and later gift tax liabilities are asserted? The potential exists for transferee and fiduciary liability claims to be asserted if estate distributions leave the estate without sufficient funds to satisfy a late-arising gift tax liability.

The role of the practitioner in advising the executor or trustee to make distributions also presents issues. For example, in W.D. Little, the estate attorney provided erroneous advice to the estate fiduciaries to pay nontax debts and distributions without taking tax liabilities into account. Fiduciary liability claims were asserted by the government.

Burden of Proof of Transferee Liability for Gift Taxes

The burden of proving gift tax transferee liability, including the value of the gift to the donee-transferee, rests with the IRS. This burden is not difficult for the IRS. There is no need to invoke state fraudulent conveyance law, as is the case with Code Sec. 6901 cases.

Release from Liability

An executor is afforded some relief in Code Sec. 2204, which permits the executor to request a discharge from personal liability by applying to the IRS for determination of the amount of estate tax. The IRS is then required to determine the tax liability within nine months of the request (or if the request is made before the return is filed, within nine months after the return is filed but not later than when the tax must be assessed). If the executor then pays the amount determined by the IRS (other than any amount being paid on extension), the executor will, in theory, receive a receipt showing that the executor is discharged from the personal liability for the tax liability.40

Conclusion

The practitioner faces some risk in handling estate and gift matters on account of transferee or donee liability for delinquent estate and gift taxes. The more straightforward set of issues is with estate taxes. Fiduciary liability for unpaid estate taxes was discussed in Part 1. In this Part 2, the narrative highlights the potent special estate tax lien rights available to the IRS, in addition to the normal and conventional general tax lien.

In addition, personal liability for unpaid estate taxes potentially could impact a host of estate transferees, either for probate or nonprobate assets.

For delinquent gift taxes, the risks include personal liability imposed on donees. Many gift transactions are not even identified by donors, or their advisors. As described in the discussion of the Marshall or Redstone cases, gift tax transactions can arise from disproportionate corporate redemptions, settlement agreements or a variety of intra-family business transactions. Years can elapse before the gift tax claim is even made, as illustrated in Redstone.

For practitioners handling estates, potential gift tax liability of the decedent can be especially painful.

ENDNOTES

2 R.S. MacIntyre, DC-TX, 2012-1 ustc ¶60,642.
3 The ex-wife argued unsuccessfully that she was not a donee of the 1995 indirect gifts. This issue is not pertinent to the discussion in this column.
4 Code Sec. 6324(b) (last sentence).
5 L.W. Poinier, CA-3, 88-2 ustc ¶13,783, 858 F2d 917, 920; C.J. Baptiste, Jr., CA-8, 94-2 ustc ¶60,173, 29 F3d 433.
6 E.S. Redstone Est., 145 TC No. 11, Dec. 60,434.
7 S. Redstone, 110 TCM 564, Dec. 60,467(M), TC Memo. 2015-237.
8 Code Sec. 6324(a)(3).
9 Code Sec. 6324(b).
10 Code Sec. 6324(b).
11 Code Sec. 6324(c)(1), (2).
12 For fuller discussion of Code Sec. 6323, see William D. Elliott, FEDERAL TAX COLLECTION, LIENS AND LEVIES (Warren Gorham & Lamont
TAX PRACTICE

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