
Folks:

Take-Away: A widow, or widower, who receives an inheritance from a deceased spouse, even if covered by the unlimited marital deduction, could find themselves paying federal estate taxes, in their capacity as a *transferee* of the decedent's estate.

Background: When federal estate taxes are not paid, the IRS can collect from those individuals who **receive** the decedent's estate's property. Individuals who control the decedent's Trust, as trustees, or who received the estate property, as either transferees or beneficiaries, are personally liable for unpaid federal estate taxes.

IRC 6324(a)(2): This Tax Code section imposes personal liability for unpaid federal estate taxes on the categories of persons who are listed in that statute who have received estate property, either on the date of the decedent's death or at any time thereafter, subject to the federal statute of limitations. This statute provides:

*If the estate tax imposed by chapter 11 is not paid when due, then the **spouse**, transferee, trustee (except the trustee of an employee trust which meets the requirements of section 401(a), surviving tenant, person in possession of the property by reason of the exercise, nonexercised, 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 decedent's death, of such property, **shall be personally liable** for such tax.*

In a 2023 federal court decision, a federal appeals court interpreted this statute to impose personal liability for unpaid estate taxes on the categories of persons listed in the statute who hold or receive estate property, either on the date of

the decedent's death, or at any time thereafter, without any concern that the transfer to the transferee, i.e., the surviving spouse, was not subject to the federal estate tax.

United States vs. Estate of Allen Paulson, Ninth Circuit Court of Appeals, (May 17, 2023)

Facts: Mr. Paulson died with an estate valued at \$200 million, most of which was held in his revocable Trust. Mr. Paulson was survived by his third wife, three sons from a prior marriage, and grandchildren, and a widow of one of his deceased sons. After Mr. Paulson's death his estate was distributed to his heirs over a few years. When Mr. Paulson's estate tax return was filed, while it paid a portion of the federal estate tax liability, it elected to pay the remaining balance in installments over 15 years pursuant to IRC 6166. The Form 706 reported a gross estate of \$187,729,626, and a net taxable estate of \$9,234,172, which resulted in an estate tax liability of \$4,459,051. The decedent's estate paid \$706,296 and it elected to defer the balance of the federal estate tax of \$3,752,755. Consequently, the IRS assessed the reported federal estate tax liability at \$4,459,051.

The trustee missed some of its installment payments, and about 4 years later the IRS terminated the IRC 6166 election and issued a Notice of Final Determination. Then the IRS entered a stipulated decision with the estate that determined that the federal estate owed an additional \$6,669,477 in federal estate taxes. [IRC 7479.] Taxes were paid in installments by the successor co-trustee (Mr. Paulson's son) until his removal about 4 years later. The son only paid one tax installment after the settlement with the IRS, and only one interest payment, but that was it. Neither the successor trustee nor anyone else made any of the subsequent installment payments of the deferred federal estate tax.

During this period of estate administration there were disputes among some of the beneficiaries- (no surprise) between the widow and the children and grandchildren from Mr. Paulson's prior marriages. In the settlement of those disputes the widow received assets that the IRS claimed were worth \$19

million (\$750,000 cash, two homes, household contents, and an ownership interest in the Del Mar Country Club.) Mr. Paulson's children and grandchildren claimed that the assets that the widow received from the Trust were worth \$42 million. Assets were transferred to the widow's living Trust in satisfaction of her claims under the Settlement Agreement. The co-trustees also transferred at least another \$7.261 million in cash from the Trust to other trust beneficiaries.

The IRS recorded federal tax liens against the estate. The various beneficiaries who had settled their dispute amongst themselves responded that Mr. Paulson's living Trust had been 'completely depleted.' The IRS then sought a judgment against the estate and Mr. Paulson's Trust, and then the trustee, beneficiaries, and transferees, for the outstanding balance of the estate's tax liability under IRC 6324(a)(2) and 31 USC 3713 and state law.

Disputed Issue: The issue before the court was whether trustees, transferees, and beneficiaries are personally liable for federal estate taxes when they were not in possession (or control) of the estate assets at the time of the decedent's death. Consequently, the legal question focused on the statutory language *or has on the date of death of the decedent, property...* The interpretive question before the court was whether the phrase '*on the date of the decedent's death*' modifies only the immediately preceding verb *has* or if it also modifies the more remote verb, *receives*?

Federal District Court: The trial court concluded that some of the individual defendants were not liable for the federal estate taxes as transferees or trustees because they were not in possession of estate property at the time of Mr. Paulson's death. With regard to one individual beneficiary the judge determined that she was not liable as a transferee since she did not receive any life insurance benefits. Nor was the widow liable since she did not receive her share of the estate's property until 3 years after Mr. Paulson's death, i.e., after the Settlement Agreement. The trial judge further concluded that a son, daughter, and granddaughter were not liable for any unpaid federal estate taxes as transferees and trustees because they, too, were not in possession of the estate property at the time of Mr. Paulson's death.

Appeals Court: It took the Court of Appeals only 52 pages to parse the statutory language to conclude that an individual trustee, beneficiary, or transferee need not be in possession (or control) of the decedent's assets at the time of death to become liable under the statute for the payment of federal estate taxes. Accordingly, the trial court was reversed on appeal.

Parsing the Statute: *"Moreover, accepting the defendants' interpretation would require us to read the statute as if it were punctuated differently-to essentially rewrite the statute. Specifically, we would either need to read the statute as if the two verbs 'receives' and 'has' appeared together in an integrated clause and were separated from the limited phrase by a comma... But Congress did not structure the statute this way."*

Assets that are Receivable: *"That clause applies 6324(a)(2) to 'property included in the gross estate under sections 2034 to 2042, inclusive.' These sections, in turn, attach personal liability for the unpaid estate taxes on the gross estate to assets that are receivable... Thus, the statute clearly anticipates that at the time of the decedent's death, the categories of persons listed in the statute may receive the expectation of the right to receive certain state property. In other words, they may have a receivable interest on the date of the decedent's death but not actually receive property on that date... Under the plain language of section 6324(a)(2), those who fit within the categories of persons listed in the statute are personally liable for the estate taxes on such property. The statute also explicitly applies to those who already have or possess estate property on the date of the decedent's death, such as a 'surviving tenant' or a 'person in possession of the property.'"*

Ability to Pay is Irrelevant: *"But the statute does not state that liability for unpaid estate taxes attaches only to those who can pay the taxes on the date of the decedent's death. Instead, the statute imposes personal liability for the unpaid estate taxes based on the receipt or possession of property from the gross estate."*

Surviving Spouse as *Transferee*: “While the surviving spouse may receive her share of the deceased spouse’s estate as an untaxed marital deduction transfer, under IRC 6324(a)(2) the surviving spouse is still liable under the statute to pay the unpaid federal estate taxes even though her distribution from the trust did not generate any federal estate tax liability. The surviving spouse is a transferee of the decedent’s estate.”

Tax Liability that Exceeds Value of Property Received: Before an individual can be subjected to estate tax liability under the statute that exceeds the value of the property that they received from the decedent’s estate, *all* of the following events, some of which are remote and unlikely, must occur:

1. The property must have depreciated after the date of the decedent’s death to the point that it is worth less than the tax liability, which is calculated as a percentage of the amount of the taxable estate.
2. The Personal Representative (or trustee) must have failed to pay the estate tax before distributing estate property. This imposes personal liability on the Personal Representative (or trustee) for distributing any portion of the estate before *all* federal estate tax is paid. [CFR 20.2002-1.]
3. The estate must have ‘divested itself of the assets necessary to satisfy its tax obligations.’ [IRC 6324(a)(1).]
4. The statute of limitations must not have expired by the time the property is distributed or the government attempts its collection.
5. A transferee, beneficiary, or other recipient of the estate property must not have disclaimed or refused the property. [IRC 2518; C.F.R. 25.2518-2.]
6. The government must successfully seek to impose tax liability on a transferee, beneficiary, or other recipient of estate property in an amount that exceeds the value of the property he/she received.

Conclusion: We often conclude that whatever the surviving spouse receives on the death of his or her spouse is protected from tax due to the unlimited federal estate tax deduction. [IRC 2056.] Technically that is a true statement.

However, the surviving spouse is also a *transferee* from the decedent's estate, and if federal estate taxes go unpaid, the surviving spouse may still be liable to pay the unpaid federal estate tax liability, even though their distribution did not create any of the federal estate tax liability that is subject to collection. Such is the literal reading of IRC 6324(a)(2).

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